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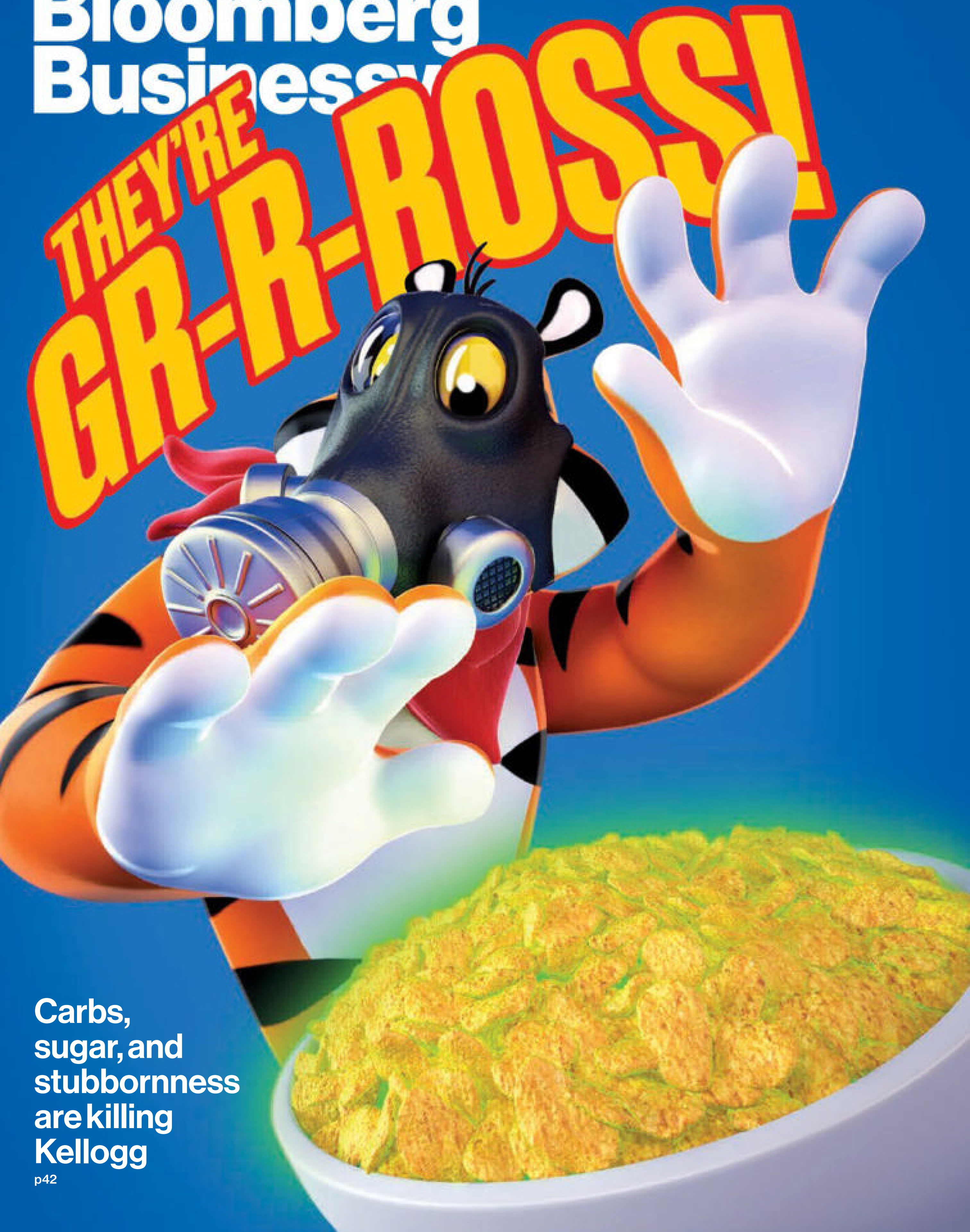
Bloomberg Businessweek



Carbs, sugar, and stubbornness are killing Kellogg

p42

Bloomberg Businessweek

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PHOTOGRAPH BY MARK PECKMEZIAN FOR BLOOMBERG BUSINESSWEEK

Bloomberg Businessweek
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COVER AND COVER TRAIL: ILLUSTRATION BY BIGSHOT TOYWORKS

Cover Trail

How the cover gets made

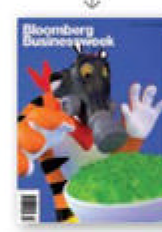
1
"Cover is on Kellogg. Sales have been falling for a lot of its cereal brands."

"What are people eating instead?"

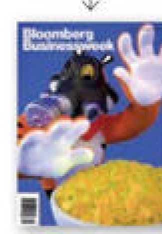
"Yogurt, breakfast sandwiches, breakfast bars, GMO-free cereals. There's a lot of competition now."

"Somewhere Tony the Tiger is crying. Speaking of which, we should do Tony the Tiger crying—or vomiting, or punching himself in the face, or all three simultaneously."

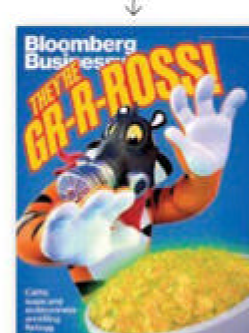
(*to illustrator*)
"Hello. Can you make Tony the Tiger vomit, or cry, or punch himself in the face, or all three? Next to a bowl of Frosted Flakes? Or something else that shows Frosted Flakes has lost its appeal?



2
"This is great. A bit more subtle than vomiting. Can he be a little more appalled by the cereal, though?"



3
"Now we just need a headline. Something that communicates the idea with similar subtlety."

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Corrections & Clarifications

"Rest in Peace for Less" (Features, Feb. 23-March 1, 2015) misstated the kind of law that requires funeral homes to post placards about the preservative qualities of sealed caskets: It's a California law, not a federal one.

ARCE: PHOTOGRAPH BY JOÃO CANZIANI FOR BLOOMBERG BUSINESSWEEK; BRAGA: DENIS BALIBOUSE/REUTERS; HOOVER: DAVID PAUL MORRIS/BLOOMBERG

SIEMENS

Toward a Bright Energy Future

Technological advances in gas and oil production have brought about a U.S. energy boom

Spurred by advances in automation and digitalization, the United States has become the world's biggest producer of oil and natural gas, surpassing such stalwarts as Saudi Arabia and Russia in an energy revolution that has served as the engine of the nation's economic recovery. Whereas the U.S. produced 9.2 million barrels of crude oil a day in 2012, daily output now exceeds 11 million barrels, and, according to the International Energy Agency, is expected to surge to 14 million barrels a day in 2020.

However, this impressive output happens to coincide with extreme price pressures in the oil market, as a number of factors—highlighted by OPEC's unchanging production levels—caused the international benchmark price of oil to drop nearly 50 percent in 2014. As such, the question today isn't a simple one of supply or demand—the IEA projects worldwide oil demand to increase from 700,000 to 910,000 barrels a day in 2015—but of how to lower costs in an industry that accounts for 20 percent of private fixed-structure spending in the U.S.

"Growth across the energy value chain depends on producing, transporting and processing new resources in the most efficient and cost-effective way possible," says Lisa Davis, a member of the managing board of Siemens AG who heads energy operations for the engineering and electronics conglomerate. Through its use of data analytics to drive efficiency and reliability, Siemens has already transformed the industries of advanced manufacturing and power generation. Now, says Davis, "we want to do the same for the oil and gas industry."

Doing so will require introducing automation into all parts of the process, from extraction to refining and everything in between, something Siemens is well-positioned to do thanks to technologies and instrumentation that have made their way into every part of the product cycle. And thanks to this broad technological integration, Siemens offers expertise that runs the gamut from electrical systems to rotating equipment.

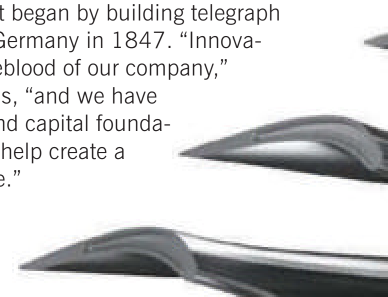
Siemens' commitment to the latter is on display in its recent acquisitions. Through its purchase of Rolls-Royce Energy last year, Siemens has broadened its access to the bustling market for aero-derivative gas turbines. Likewise, a deal to acquire Dresser-Rand—the technology choice for compressors, turbines and engines—is expected to be closed this summer. Together, they help form what Davis describes as "the most complete rotating equipment provider in the market."

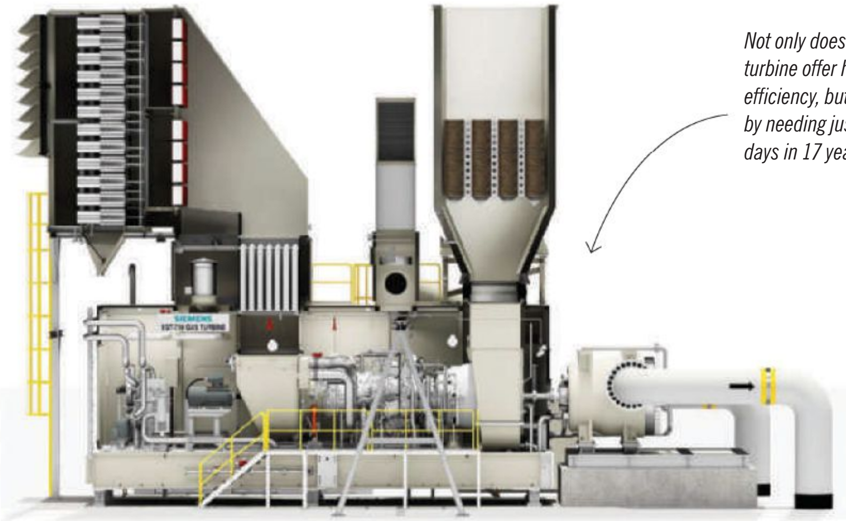
Tomorrow's advances today

If the previous chapter of the U.S. oil and gas story was about the upstream (the exploration and production of crude and natural gas), the next will be all about the midstream—the infrastructure needed to bring these resources to market. "We want to revolutionize the speed, efficiency and reliability with which we move oil and gas from extraction to the end user," Davis explains, and this includes everything from pipelines and tank farms on land to very large crude carriers (VLCCs) and liquefied natural gas (LNG) tankers at sea.

By helping partners seamlessly deliver natural resources from wellhead to end user, Siemens promises to remain an integral part of the U.S. energy renaissance. But as oil and gas production increases, the country doesn't possess the infrastructure necessary to best seize this potentially historic energy moment. "We don't have enough pipelines to move it, enough facilities to store it or enough manufacturing facilities to convert it to fuel for our cars or electricity for our homes," says Davis.

This is why, even as it emerges as the only player capable of automating and innovating the cycle from end to end, Siemens has its eye on the future—no surprise coming from a forward-thinking company that began by building telegraph lines across Germany in 1847. "Innovation is the lifeblood of our company," Davis explains, "and we have the culture and capital foundation that can help create a cleaner future."





Not only does the Siemens SGT-750 gas turbine offer high output and market-leading efficiency, but it takes reliability to new levels by needing just 17 scheduled maintenance days in 17 years.

So, while Siemens has already introduced dozens of innovations across the energy value chain, it is not content to stand still. Even though experts believe the price of oil has already seen its floor, recent volatility highlights not just the need to apply more energy efficient solutions, but also to continue working on the technologies of tomorrow.

As a worldwide "all of the above" approach to reducing greenhouse gasses takes hold, wind power and other renewables can complement carbon-based energy sources like natural gas—itself a prime building block for lower carbon emissions—in a shift toward distributed power generation. Due to the intermittency inherent in renewables, however, there is a need for flexibility in power generation to ensure reliability, and Siemens is there to make sure no one has to choose between flexibility and efficiency.

Thanks to its leading-edge Flex-Plant solution—the first of its kind in the U.S.—gas-fired plants are able to ramp up quickly when there is a gap between renewable and traditional energy sources. Likewise, the plant can even maintain base load emissions levels during this intensive process with the help of Siemens' Clean-Ramp technology.

"This is precisely the equipment that the oil and gas industry needs to create the next chapter of growth," adds Davis, who is understandably excited about Siemens' role in this energy resurgence. "Whether in production, transport or processing—on land or at sea—we are positioned to support our customers by automating the oil and gas value chain. With energy so abundant, we are seeing the reindustrialization of the American economy, which is attracting manufacturing investments from around the world. It's a game-changer for the U.S. economy."

—Mike Olson

"Growth across the energy value chain depends on producing, transporting and processing new resources in the most efficient, cost-effective way possible."

—Lisa Davis, Siemens

Opening Remarks

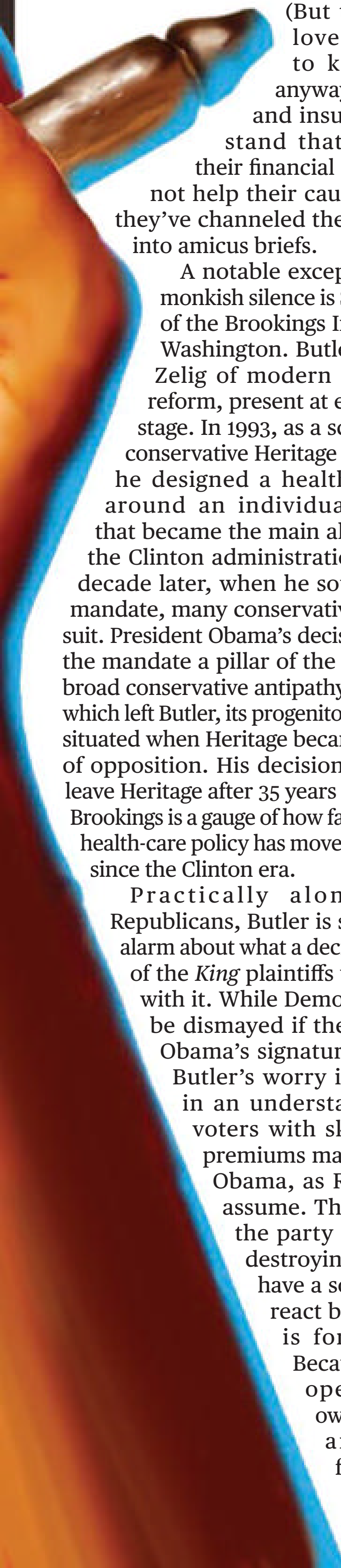
The Return Of the Death of Obamacare

By Joshua Green

The Supreme Court is once again being asked to strike down the Affordable Care Act. Is Washington ready for the chaos it would unleash?

The possibility that the U.S. Supreme Court will soon eliminate federal subsidies for people buying health insurance through the Affordable Care Act is the biggest story in politics and economics that no one wants to talk about. But the stakes in *King v. Burwell*, which the court will hear on March 4, could scarcely be higher: If the plaintiffs prevail, millions of people in 34 states who bought insurance on federal exchanges would suddenly lose the subsidies that make it affordable. Consequently, most would lose their coverage. A Rand study pegged the number at 9.6 million people, with premiums soaring 47 percent for those still able to afford them. "Everyone agrees this would be a cataclysmic hit to the insurance market," Michael Kolber, a health-care attorney at Manatt, Phelps & Phillips, said at a Feb. 13 Bloomberg Intelligence panel on *King v. Burwell*.

The immediate effect of a ruling against the ACA would be to hurl the political system, and no small part of the economy, into chaos. Yet there's little sign



that Washington is preparing for that scenario. Democrats won't talk about what they would do because they don't want the court to believe they could contain the fallout. Republicans don't want to talk because they're loath to admit that, even after voting 67 times to repeal or defund the ACA, they have no plan to help the millions who would be affected. (But they'd sure love the court to kill the law anyway.) Hospitals and insurers understand that bewailing their financial plight might not help their cause. Instead, they've channeled their warnings into amicus briefs.

A notable exception to this monkish silence is Stuart Butler of the Brookings Institution in Washington. Butler, 67, is the Zelig of modern health-care reform, present at every critical stage. In 1993, as a scholar at the conservative Heritage Foundation, he designed a health-care plan around an individual mandate that became the main alternative to the Clinton administration's plan. A decade later, when he soured on the mandate, many conservatives followed suit. President Obama's decision to make the mandate a pillar of the ACA ignited broad conservative antipathy to the idea, which left Butler, its progenitor, awkwardly situated when Heritage became the locus of opposition. His decision last July to leave Heritage after 35 years and move to Brookings is a gauge of how far Republican health-care policy has moved to the right since the Clinton era.

Practically alone among Republicans, Butler is sounding an alarm about what a decision in favor of the *King* plaintiffs would carry with it. While Democrats would be dismayed if the court guts Obama's signature initiative, Butler's worry is grounded in an understanding that voters with skyrocketing premiums may not blame Obama, as Republicans assume. They'll expect the party hellbent on destroying the law to have a solution—and react badly if none is forthcoming. Because 16 states operate their own exchanges and therefore won't be affected by the court's ruling, Butler believes the ACA will stagger on and eventually recover, since voters won't abide a system wherein some states have affordable, federally subsidized health-care coverage and others do not. Absent an alternative, he says, the ACA will rise again like a horror-movie killer. "People who believe the ACA instantly goes away are deluding themselves," he says. "By not doing anything to develop a Republican vision of how to move forward, they could end up with the very nightmare they're trying to avoid."

On the political front, lawmakers would have to decide what to do about the people in 34 states who would lose their subsidies. In theory, Congress could tweak the law to restore them. But Republicans have no interest in this, nor have they shown any sign of being able to agree on any other fix, much less one that Obama would support. That would throw responsibility to the states, which would each have to try and devise their own solution. Some would probably manage; others, especially those with Republican governors or legislatures implacably opposed to the ACA, almost certainly would not.

The result would not just leave millions uncovered but also risk destroying the individual health-care markets in states that don't act. According to a brief filed by a consortium of hospital trade groups, "A market without subsidies will trigger a premium 'death spiral' in those states: With subsidies gone and premiums pushed higher, younger and healthier patients will likely drop coverage. Those that remain, paying the higher rates, are likely to be sicker and use more health-care resources. That, in turn, will push rates for everyone in those states even higher, which will cause more to drop coverage, and so on."

On the business front, the effects would be no less significant. "If the U.S. health-care system were its own economy," says Butler, "it would be the sixth-largest in the world—larger than Britain's." Entire segments of the health system redesigned their business models to take advantage of the ACA's incentives. Hospitals, for instance, were given a trade-off: They stopped receiving government payments to offset the cost of treating the uninsured, cuts that amount to $269 billion over a decade. In return, they were promised millions of new patients insured through federal subsidies. "All the major hospital systems and big insurers like Kaiser and Geisinger spent a ton of money adapting to the ACA," says Butler. If subsidies vanish, "suddenly the market is misaligned. If you've hired all these new doctors and health-care workers to cover all these new people walking in the door, and they don't come, what do you do? You lay them off."

A ruling against the law could leave millions uncovered and destroy individual health-care markets in many states

This is no mere hypothetical. In 2012, after the ACA had ended hospital reimbursement payments, the Supreme Court ruled that state Medicaid expansion was optional, rather than mandatory, as the law had decreed. Hospitals in the states that chose not to expand Medicaid lost one source of income without gaining a new one to offset it (Medicaid patients). At least 43 hospitals have closed as a result, with the pace picking up each year, according to an investigation by *USA Today*.

The ACA also opened up a flood of investments in digital health ventures. A recent study by StartUp Health, a New York incubator, found that $14.5 billion has been invested since the law was signed, including $6.5 billion last year. "If Congress is unwilling to take action, it would clearly make it less attractive to invest in things related to the coverage expansion," says Bob Kocher, a partner specializing in health-care IT at the venture capital firm Venrock. "It slows the rate of change in the health-care ecosystem in a way that's bad for everybody and hurts companies going after these new patients, who are going to suffer."

If the court strikes down federal subsidies, Butler hopes Congress will use the resulting pressure from voters and health-care companies to implement a more conservative vision of health-care reform—changing the tax treatment for employer-sponsored health plans and allowing states much greater flexibility to spend Medicaid money and design their own systems (abolishing the individual mandate if they wish).

But Butler's plan would require a Republican contingent willing to go along—and so far none has materialized. "When Clinton came in, there was clear momentum toward a sweeping reform of the health system," he says. "There was a big debate on the right about whether to try and match it, but with a different structure, or just to attack." Butler sided with those who wanted to fix the problem. That's much harder now. "Today, I think we're in the exact same situation," he says. "Only this time there isn't a core group of people who have coalesced around a basic alternative."

It's possible such a group will emerge as the court prepares to issue a decision, probably in late June. The party's presidential aspirants may also take an interest

in Butler's alternative, given the failure of efforts to repeal the law. "You can bang your head against the wall all you like," says Butler. "If it doesn't fall down, then maybe you should go around it or figure out some other way to move forward." So far, though, no one has called. But if the court sides with the *King* plaintiffs and the blowback is as intense as some people expect—well, maybe then Butler's phone will start ringing.

Why the Right Is Wrong

By Paul M. Barrett

Three years ago the first Supreme Court challenge to the Affordable Care Act questioned whether Congress had the constitutional authority to require individuals to acquire health insurance. Chief Justice John Roberts joined the four liberal justices to uphold the individual mandate as an exercise of congressional taxing power. In *King v. Burwell*, the second anti-Obamacare salvo to reach the court, the president's foes are trying a statutory argument rather than a constitutional one. Their target is the law's provision of federal tax subsidies to people who otherwise might not be able to afford insurance premiums.

On one level the challenge, led by the Competitive Enterprise Institute, a conservative Washington advocacy group, dwells on a trivial-seeming semantic flaw in the ACA. Lawyers take semantics seriously, of course, and this one could undermine coverage for millions of newly insured Americans. The statutory attack makes sense, however, only when combined with a story conservatives have concocted about how the ACA became law—a story that rings false. Whether Roberts believes it could determine whether Obamacare survives.

The ACA has a three-part structure. First, it bans insurers from denying coverage based on preexisting conditions. Standing alone, that provision would cause many consumers to postpone seeking insurance until they get sick, a tendency that would cause carriers to hike prices, deterring more people from buying policies. To prevent this fatal dysfunction and assure that healthy people jump into the insurance pool, the individual mandate upheld in 2012 requires that everyone obtain coverage. The third component—the one now under fire—is the provision of tax subsidies to allow less-well-off consumers to participate.

Congress instructed the states to establish online marketplaces, or exchanges, through which residents can buy health policies. In states that don't comply, the ACA provides for the federal government to set up exchanges. The act authorizes tax benefits for people who purchase insurance through an "exchange established by the state." At last count, only 16 states and the District of Columbia had set up exchanges. In 34 other states, mostly led by Republicans, the U.S. Department of Health & Human Services has had to step in to get exchanges working.

Of the more than 8 million customers who've signed up for insurance via federal exchanges, more than 85 percent qualified for subsidies. The Internal Revenue Service interprets the law as making tax subsidies available to anyone of modest income, regardless of whether their state set up its own health exchange. Many other parts of the 900-page statute refer to both federal and state exchanges without so much as a hint that legislators meant to bestow tax subsidies only on customers of state exchanges.

The plaintiffs in *King v. Burwell*, however, contend that since the ACA explicitly mentions tax subsidies only for people who buy insurance through an "exchange established by the state," those living in the 34 states that haven't created their own exchanges shouldn't receive tax subsidies. Excluding them would blow a gaping hole in the ACA, effectively denying millions of Americans their newly obtained coverage. The main brief for conservative activists, written by Michael Carvin, a former official in the Reagan Justice Department, insists that Congress deliberately intended to booby-trap the ACA as a way to induce states to set up their own exchanges. "Any English speaker would immediately understand that no subsidies are available for coverage obtained on an exchange established by HHS," Carvin writes.

This is where the legal challenge to the ACA relies on a highly suspect conservative narrative of how it was passed. Carvin argues in his brief that "political realities" drove Congress to threaten the states with denial of tax subsidies if they didn't establish their own exchanges. For certain moderate Democratic senators, the brief adds, "it was important to keep the federal government out of the process."

The case rests on a story conservatives concocted about how the ACA became law—a story that rings false

The problem with that contention is that it's devoid of support in the congressional record. As Solicitor General Donald Verrilli points out in the administration's brief, during the time Congress considered the ACA, not a single member—not one—"ever suggested the tax credits would be available only in states that established their own exchanges.... Any such suggestion would have produced a firestorm of controversy, but there was none."

Tellingly, Carvin tries to bolster his narrative by quoting Jonathan Gruber, a Massachusetts Institute of Technology professor who advised the White House on health reform. Gruber gained notoriety for videotaped comments he made in 2013 suggesting that the ACA had passed because "stupid" voters didn't understand it. In 2012, the Carvin brief recounts, Gruber asserted that "if you're a state and you don't set up an exchange, that means your citizens don't get their tax credits."

Gruber has since publicly disavowed his look-at-me outbursts, and in any event, his opinions are beside the point. He didn't vote on the legislation. It's difficult to envision a Supreme Court ruling grounded in kibitzing from Cambridge.

In contrast, there are the highly relevant assessments of the ACA's fiscal consequences by the Congressional Budget Office and the Joint Committee on Taxation. Those analyses were critical to the act's passage and are referred to in the law itself. They were based on an understanding that tax subsidies "would be available in every state, including states where the insurance exchanges would be established by the federal government," according to a Dec. 6, 2012, letter from CBO Director Douglas Elmendorf to Republican Representative Darrell Issa of California.

The bottom line is that conservatives intent on ruining Obama's signature domestic legislation could have stuck to a simple position: that when a law says "state," it can't be interpreted to mean "state or federal government." The Supreme Court, this argument would go, shouldn't rewrite flawed legislation, no matter what the consequences.

But conservatives pushed their luck with a dubious story about congressional intent. That fairy tale ought to offend members of the court. If it has that effect on Chief Justice Roberts, it could push him toward another surprise alliance with the liberal wing, allowing Obamacare to persevere—at least for now. Ⓑ

PREVIOUS SPREAD: ILLUSTRATION BY 731; GETTY IMAGES (2)

To read Noah Feldman on *King v. Burwell* and Kavitha A. Davidson on Jameis Winston, go to

Bloombergview.com

Turn the Gas Tax Over to the States

Congress doesn't know what to do with the federal Highway Trust Fund

A political development of actual importance is occurring in Iowa: Democrats and Republicans are proposing to increase the state's gas tax. Not only is this a rational way to raise revenue to repair bridges and roads, it's also a sensible response to the federal government's abdication of the task.

A bill advancing through the Iowa Legislature would add 10¢ to the state's 22¢-a-gallon gas tax. Members of both parties have good reason to support it: More than 1 in 4 of the state's major roads are in poor condition, and an equal proportion of its bridges is structurally deficient or functionally obsolete. If the bill passes, Governor Terry Branstad, a Republican, has indicated he will sign it.

Given the low price of oil, and the declining real value of the federal gas tax, which has stood at 18.4¢ a gallon since 1993, it's a good time for states to act. Road conditions in Iowa are, unfortunately, typical of the rest of the country.

In the long run, however, the strategy of using a gas tax to pay for transportation improvements is doomed. As vehicles become more fuel-efficient, states have to find a more suitable way to pay for transportation infrastructure—and the closer it is to a user fee, the better. Oregon, for example, is experimenting with a program that charges drivers by the mile.

A gas tax, especially as it declines in value, is an imperfect proxy for a user fee. Congress has been proving this point nicely. The federal Highway Trust Fund, which is financed through the federal gas tax, is scheduled to run out of money this spring. Simply increasing the tax would be the most sensible fix. In addition to raising revenue, gas taxes create incentives for conservation, which reduces air pollution and carbon emissions. Instead, Congress has been resorting to a series of fiscal gimmicks to keep the fund afloat—anything to avoid increasing the gas tax. The latest maneuver would patch the fund by connecting it to a plan to tax repatriated foreign profits.

The jig is up. The Highway Trust Fund has become little more than a chronically underfunded redistribution mechanism—and a poorly designed one at that. States with the greatest needs (and often the highest gas taxes) tend to be shortchanged by the federal formulas, while states with lesser needs (and often lower gas taxes) benefit disproportionately.

Rather than applying another short-term fix to the fund, Congress should abolish it and direct the revenue from the gas tax to the general treasury. Or it could abolish the tax altogether, turning the matter over to the states. (Republicans could claim a victory for federalism, Democrats for fairness.) Nothing would prevent Congress from continuing to support state spending on transportation based on need and national economic priorities.

States don't need the federal government to redistribute their gas tax revenue. But they do need to start raising their own—or find other ways to increase their spending on transportation.

The Fed Doesn't Need Another Audit

Senator Rand Paul's bill to do that is a very bad idea

Federal Reserve Chair Janet Yellen mostly succeeded in her attempt to be vague about Fed policy in her semiannual appearance before Congress. On one issue, however, she was unequivocal and correct: A congressional audit of the Fed's interest rate decisions is a very bad idea.

The Fed is already "extensively audited," she said, and Republican Senator Rand Paul's bill to audit it even more "would politicize monetary policy." Had such congressional micromanagement been possible in the 1970s, she pointed out, former Fed Chairman Paul Volcker probably wouldn't have been able to defeat inflation by pushing up interest rates to double digits.

Undermining the central bank's political independence would ultimately harm the economy. Studies show that independent central bankers are better stewards of their economies than political appointees. The reason is simple: Politicians often favor easy-money policies that promote short-term growth and boost their reelection chances, even if the moves bring on inflation later.

There are more useful Fed changes that Paul could pursue, such as more openness in the bank's regulatory deliberations. Yellen could also institutionalize what she does voluntarily: brief lawmakers before her testimony to better prepare them.

She might start with Paul, who appears to suffer from misapprehensions about the bank. Sadly, he's not alone: His bill has 30 co-sponsors. A version has been adopted by the House.

Deloitte and an inspector general already audit the Fed's financial statements, its $4.5 trillion portfolio of assets and their market value, and its compliance with laws and regulations. The Government Accountability Office further reviews the Fed's internal controls.

These reports are available, in all their soporific splendor, to members of Congress. Paul surely knows this. So what's the purpose of his bill? Ask Senator Bob Corker, Republican of Tennessee, who opposes it. The bill is "an attempt to allow Congress to put pressure on the Fed's members" on monetary policy, he told Yellen. "That would not be a particularly good idea." B

ILLUSTRATION BY OTHER MEANS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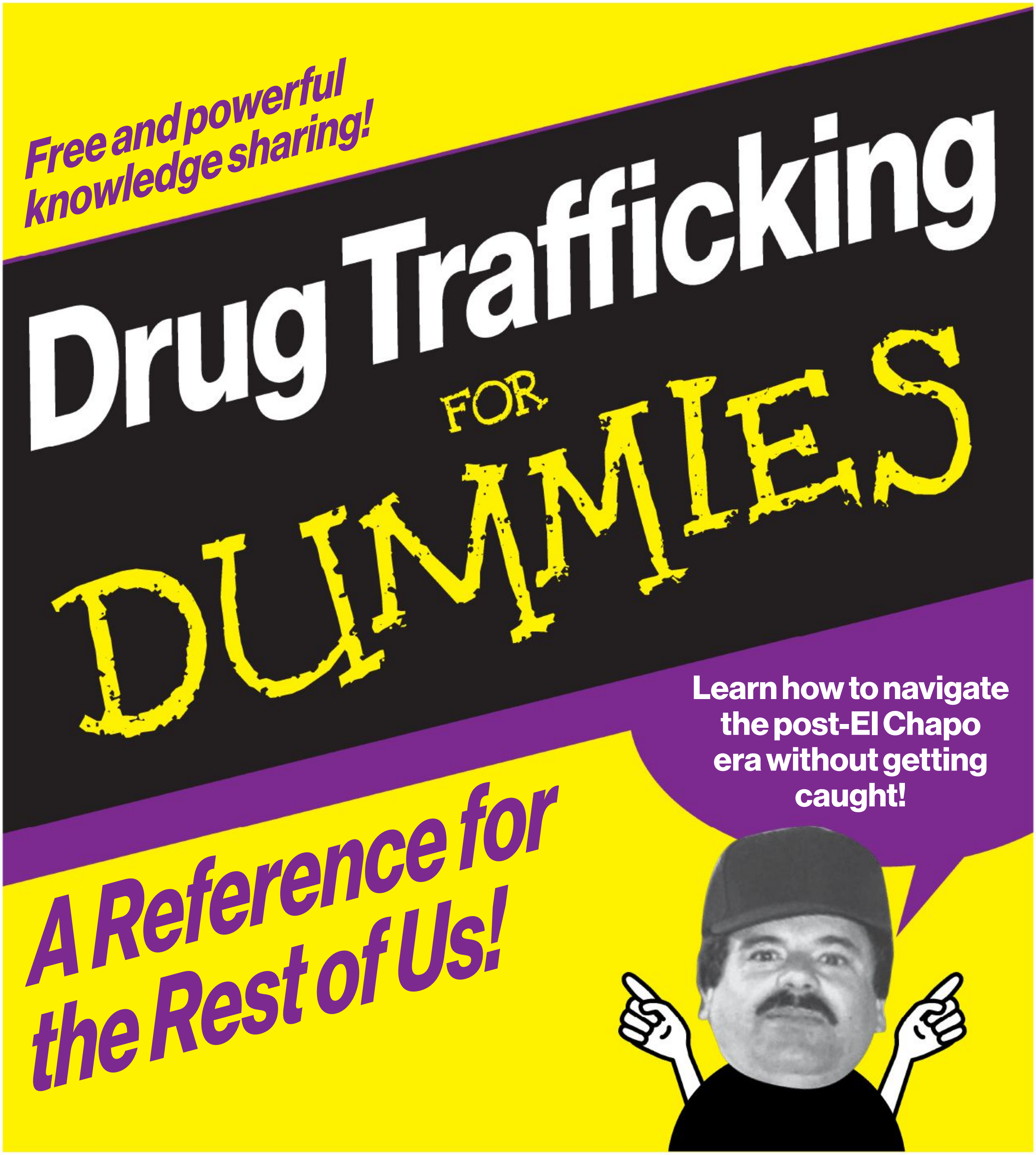
March 2 — March 8, 2015



▶ A drug lord falls, and younger gangsters scramble to replace him

▶ "Everybody's got a piece of the action now"

PHOTO ILLUSTRATION BY 731; PHOTO: DELATEALNARCO/AP PHOTO; DATA: U.S. CUSTOMS AND BORDER PROTECTION

U.S. and Mexican authorities hailed the capture of Joaquin "El Chapo" Guzman in the Pacific coast town of Mazatlan as a major victory in their war on drugs. A year later the power vacuum caused by his absence is fueling chaos on the streets of Chicago and Ciudad Juárez, across the border from El Paso.

Why are murders down and shootings up? Rookie shooters with bad aim.
—"Noonie" Ward, former Chicago gang leader

As head of the Sinaloa cartel, Mexico's largest, Guzman was a ruthless enforcer of discipline. He employed violence to protect his distribution routes and intimidate rivals. The kingpin of kingpins, Guzman had the sway to settle disputes with other drug traffickers. In Chicago, his distribution center for the U.S., he cast a long shadow: Few dared cheat the Sinaloa cartel.

The order Guzman imposed is starting to dissolve. At least two of Guzman's lieutenants are in a struggle to control the Sinaloa organization. The resurgent Juárez cartel is trying to retake the narcotics supply routes that Sinaloa wrested from the Juárez group in a drug war five years ago that cost more than 10,000 lives. "The Juárez cartel is taking back Juárez. We've seen a recent spike in violence in the last couple of weeks," says Oscar Hagelsieb, an assistant special agent in charge with the U.S. Homeland Security Investigations office. He says Guzman's capture "demoralized people that were fighting for Chapo outside of the conventional strongholds and rallied rival cartels."

Guzman secured his near-mythic status by escaping from prison in a laundry cart in 2001 and later unleashing an assassination spree of rival drug lords. Afterward he controlled much of the narcotics entering the U.S. His nickname—"Shorty" in English—belied his outsize reputation. A grade-school dropout, he transformed the drug trade by centralizing everything from warehousing and distribution to collection and transport of money back to Mexico. Five months before his arrest, the U.S. Drug Enforcement Administration's top official in Chicago at the time, Jack Riley, called Guzman "a logistical genius." Guzman instilled such fear that he could enforce his rule in northern U.S. cities far from his heavily guarded compound in Mexico's Sierra Madre mountains.

The Sinaloa cartel long provided much of the heroin, cocaine, and meth sold in the Midwest. Chicago, whose crime commission formally labeled Guzman as "Public Enemy Number One" in 2013, now feels the impact of El Chapo in a different way. The decline of the biggest gangs, many of them retailers of Sinaloa drugs, has spurred the city's 70,000 gang members to form ever-smaller groups—some 625, according to Chicago police—all fighting for their piece of turf. Police sources blame a flood of illegal guns for the 12 percent rise in shooting incidents in the city last year. But an ex-gang leader says it's because Guzman's shadow is gone. The low-level gangsters "aren't fearing anybody," says Harold "Noonie" Ward, who once ranked high up in Chicago's Gangster Disciples gang, which peddled Sinaloa drugs. As for Chicago's 3 percent drop in murders, chalk it up to rookie gangsters with bad aim, Ward says.

Absent Guzman, traffickers from the Sinaloa cartel have had to find creative ways to avoid not only police but also bandits in Mexico and the U.S. who no longer fear retribution for ripping off a load of drugs from Guzman's former foot soldiers. Traffickers for Sinaloa are using new methods of delivery, even drones. "It's very tech-savvy," says Joseph Lopez, a Chicago attorney who represents accused traffickers.

While Guzman would ship drugs hidden in the trunk of a family's car, his followers have recently ramped up production of harder-to-detect liquid meth at their labs in Mexico. It can be transported in propane tanks, tequila bottles, even by letters soaked in the stuff. On Feb. 8 border authorities in California arrested a man who was hiding more than 15 gallons of it in a special container placed in the fuel tank of a Ford pickup, according to U.S. customs officials. "If you can turn it into a liquid form, you can put it into almost anything," says Francis Brown, assistant director of field operations at U.S. Customs and Border Protection's El Paso office.

Guzman shunned social media, but the new ranks of traffickers embrace it to boast, recruit, and deal. "Like any of the younger generation, they're so much more gifted with electronic devices, so they come up with ways to utilize social media to benefit them," Brown says. "But they also do things that give themselves away." Last fall the Mexican military captured the son of one of Guzman's partners after he posted photos on Twitter of his lavish lifestyle, which included guns, cars, and parties. Attorney Lopez says he's come into court to find prosecutors with elaborate presentations drawn from an accused trafficker's text messages.

Along the 500-mile stretch of the border that includes El Paso and Ciudad Juárez, authorities seized 247 pounds of heroin from October 2013 to September 2014—almost triple the haul of the year before. New restrictions on prescription drug use are driving more U.S. addicts to heroin. And the fragmentation of drug groups in post-Guzman Mexico may mean more freelancers are trying their hand at producing heroin, says national security analyst Alejandro Hope, who's based in Mexico City. "There could be more traffickers participating than the Sinaloa cartel, increasing the supply," says the ▶

After El Chapo

Change in the weight of drugs seized along the Mexican border from the western edge of New Mexico to Big Bend National Park in Texas, from fiscal 2013 to fiscal 2014

Methamphetamine
+23%
Liquid meth can be smuggled in propane tanks and water bottles

Heroin
+187%

Cocaine
-21%
More coke is going to Europe

Marijuana
-5%
Fell by 9,419 pounds

former Mexican intelligence official.

Mexican government statistics show murders dropped 15 percent last year. But kidnappings rose 30 percent, says Asociación Alto al Secuestro, which offers aid to families of kidnap victims. Guerreros Unidos, a splinter group of a Sinaloa rival, allegedly murdered 43 students in the town of Cocula last September. Authorities say the students were kidnapped by corrupt police on the orders of the gang-connected wife of a politician.

Cocaine seized by U.S. authorities along the border from New Mexico to West Texas (the same stretch that witnessed the rise in heroin shipments) fell to 644 pounds in fiscal 2014 from 817 pounds the previous year. That drop suggests that some longtime cocaine producers from Peru and Colombia have decided to sell more of their drugs in Europe, where prices are higher than in the U.S. The switch reflects a post-Guzman world where some of the most experienced suppliers would rather avoid the increased risk that Mexico's less seasoned gangs pose. Says ex-gangster Ward: "When they got Chapo, that means that everybody's got a piece of the action now. Everybody wants to be the man." *—Mario Parker, Nacha Cattan, and Ben Bain, with Elizabeth Campbell and John Lippert*

The bottom line The fall of cartel chief Joaquin Guzman has rearranged the violent and lucrative Chicago-Juárez drug trade.

Interest Rates

How Productive Is the U.S.?

▶ **The little-understood measure is crucial to managing the economy**

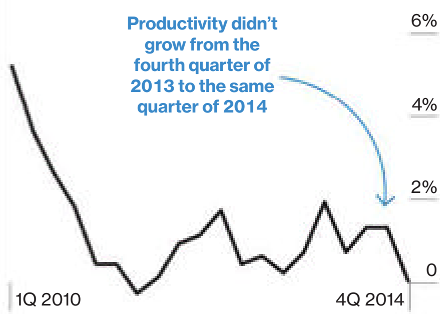
▶ **"It is the fundamental determinant of people's standard of living"**

Productivity is probably the most important measure of economic health that policymakers know the least about. Essentially it's how much a worker produces in an hour, and understanding its rate of change helps determine the timing and extent of interest rate hikes by Federal Reserve Chair Janet Yellen and her colleagues.

If productivity is growing briskly, Yellen can postpone raising rates:

Slowpoke

Year-over-year change in productivity by quarter



DATA: BUREAU OF LABOR STATISTICS

Productive workers don't heat up an economy too fast because they use existing equipment and factories efficiently. If employers have only less productive workers at their disposal, they have to hire more of them to get the same amount of work done. That means higher costs for wages, which would trigger inflation and calls for an early rate hike. Saying that the economy is improving and wages may be starting to rise, Yellen laid the groundwork for an interest rate increase later this year in her Feb. 24 testimony to Congress.

Productivity is driven by innovation and other forces economists can't readily quantify, such as changes in work practices. These murky influences are symptomatic of the "ignorance" of economists, according to the late economist Moses Abramovitz. "It is the fundamental determinant of people's standard of living, yet we know so little about what drives it," says Barry Bosworth, a senior fellow at the Brookings Institution and a former adviser to President Jimmy Carter.

According to former Fed Vice Chairman Alan Blinder, economists—including those at the Fed—typically don't have a good idea of how fast productivity will grow in the next few years. The long-run trend is "hugely important," but "it can take years" to recognize any changes, he says.

Productivity's recent performance as measured by the Department of Labor hasn't been encouraging. Output per hour worked in U.S. businesses has risen by an average of 0.6 percent in the last four years, compared with a 2.2 percent average in the last 25 years. Productivity dropped at a 2 percent annual pace in the fourth quarter. Yellen said it would be "very depressing" if the recent slowdown was the new norm, though it's too soon to conclude that.

Economists including Mark Zandi of Moody's Analytics speculate that productivity has been held down partly by forces that will dissipate as the expansion continues. One possible culprit: a surfeit of low-cost labor that's encouraged companies to hire more workers rather than improve the efficiency of existing staff through training or better equipment. Zandi sees the labor dynamic at work firsthand. Finding it increasingly difficult to hire the skilled workers it needs, Moody's is "spending more time on trying to improve the productivity of our current workforce," he says.

John Fernald, a senior research adviser at the Federal Reserve Bank of San Francisco, pegs productivity growth at 1.8 percent a year for U.S. businesses. That would allow the economy to expand by 2.1 percent annually without generating inflation. That's OK but not stellar.

Such projections are consistent with the Fed's expected increase in rates this year, the first since 2006, says Dale Jorgenson, an economics professor at Harvard. The margin of error around Fernald's forecast is wide, though. "There's basically an 80 percent chance over the next 10 years that productivity growth will average between 1 and 3 percent," Fernald says.

Technology's influence is important but also hard to predict. Banks, retailers, and other companies made use of information technology from 1995 to 2004 to boost worker efficiency. Output per hour for U.S. businesses advanced at a 3 percent annual pace during the decade. Much of the debate among economists centers on whether the U.S. can recapture that vibrancy. Erik Brynjolfsson, a professor at the Massachusetts Institute of Technology, is optimistic. He sees the economy experiencing a "fundamental transformation" driven by robotics and other technologies.

"The fruits of the third industrial revolution may be coming to an end."
—Robert Gordon, Northwestern University professor

Robert Gordon, a professor at Northwestern University, is more downbeat. "The fruits of the third industrial revolution [information technology] may be coming to an end," says Gordon, a member of the economic panel that

dates the start and finish of U.S. recessions. He sees productivity expanding at the lower end of Fernald's 1 percent to 3 percent band. Former Treasury Secretary Lawrence Summers says it's hard to square the "enormous anecdotal evidence" of technological advances Brynjolfsson cites with recent "dismal" productivity statistics. "That is a major puzzle," Summers, now a Harvard professor, told a Feb. 19 conference in Washington sponsored by the Brookings Institution.

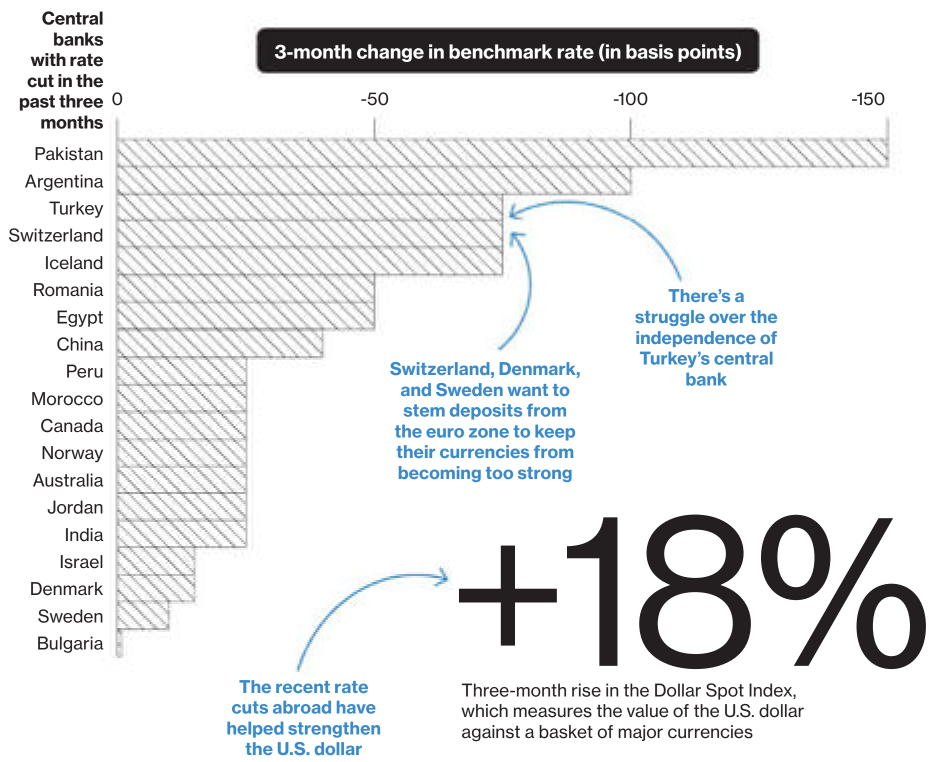
Senior economist J. Christina Wang of the Boston Fed says productivity could pick up in the next few years as companies become more confident and invest more. Still, total factor productivity, which includes innovation, seems to have moved "back into the slow lane" after its 1995 to 2004 surge, she says. Wang pegs the long-run potential growth rate of the U.S. economy at 1.7 percent to 1.9 percent.

History shows how important it is that the central bank get the productivity outlook right. A sudden slowdown in the 1970s blindsided the Fed and led to a double-digit increase in inflation because officials kept monetary policy too loose as oil prices surged; U.S. workers weren't productive enough to counter the extra costs of pricier crude. Sometimes the Fed gets it right. In the late 1990s, then-Chairman Alan Greenspan correctly saw that output per hour was accelerating and held back from raising interest rates, allowing unemployment eventually to fall below 4 percent. —*Rich Miller*

The bottom line If productivity doesn't improve, wages will rise slowly and companies will hesitate to invest.

Currencies Rumors of War

Of the 53 central banks tracked by Bloomberg, 19 have dropped their benchmark interest rates in the past three months. Low rates encourage consumers to borrow and spend, increasing domestic consumption. They also devalue currencies, making exports cheaper. That's good for the countries selling but hard on countries flooded with cheap products. —*Brendan Greeley*



DATA: COMPILED BY BLOOMBERG

Pollution

China's Steel Country Confronts Reality

▶ Mill shutdowns in Hebei province worsen industrial China's ills

▶ "Our economy is collapsing, and we are facing a crisis"

The city of Handan in Hebei province is the birthplace of Qin Shihuang, the first emperor of China. That illustrious history isn't apparent today. Aging, coal-burning steel factories belch grime over the city of 1 million, one of China's 10 most polluted. Dotting the downtown area are half-constructed high-rises, relics of a property bubble that started more than five years ago but was finally punctured last summer after the central government in Beijing curtailed credit and developers stopped paying creditors. Locals who lost their savings in dodgy real estate investments regularly block city streets in angry protests, demanding their money back from the developers.

The collapse of the property market is only one of Handan's problems. Hebei province, which nudges up against Beijing, is heavily industrial, and in China, heavy manufacturing means pollution. The sulfur dioxide, nitrogen dioxide, and dust from Hebei's smokestack industries end up fouling the air of Beijing, and the government wants to make the capital breathable again. The only solution is to wean Hebei off manufacturing.

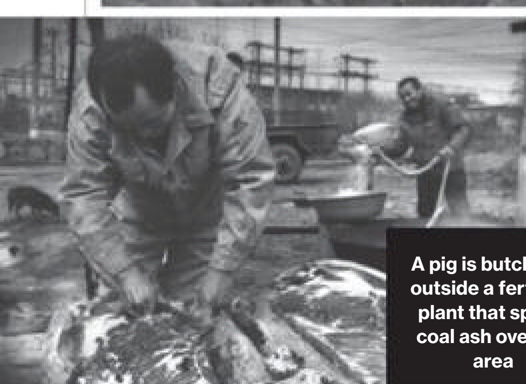
Last year the province's economy was one of China's worst-performing, growing 6.5 percent, below its 8 percent target. Hebei's mills produce some 25 percent of China's more than 800 million tons of steel. The province is one of the country's biggest glass and cement manufacturers. All three industries face serious oversupply, much of it built up since cheap loans became available after the 2008 global financial crisis. China's steel factories run at 72 percent of capacity: A mill generally has to run at 80 percent to make a profit.

Under pressure from top leaders, provincial authorities have promised to cut capacity in steelmaking and cement manufacturing by 60 million metric tons each by the end of 2017 and reduce coal use by 40 million tons.

Thousands of factories have already been closed, and thousands more will suffer the same fate. "Our economy is collapsing, and we are facing a crisis," says Wang Lihe, a cab driver ▶

Hebei province

Coal trucks wait at a power plant between Handan and Xingtai, two of China's most polluted cities



A pig is butchered outside a fertilizer plant that spews coal ash over the area

◀ for the past five years. He says his monthly earnings have dropped from 5,000 yuan ($800) last summer to 3,000 yuan to 4,000 yuan today. "My place used to be full. Now look at it," says Su Xiushang, whose empty restaurant sits near the east gate of Handan Iron & Steel, the city's biggest mill. "Handan was a rich town with its history and steel. Now regular people can't even afford to eat out."

By the time Hebei finishes restructuring its industries, an estimated 200,000 steel jobs will be gone, the Hebei Provincial Development and Reform Commission says. The factory shutdowns fit with a national plan to consolidate steel production in larger, more efficient mills closer to the ports that bring in Australian iron ore, says Michael Komesaroff, principal of Urandaline Investments, a Melbourne-based consulting firm. "The transition is coming at a much faster rate and on a larger scale than had been previously anticipated. That's making it much harder for everyone to manage," Komesaroff says.

China's leaders are trying to bolster the province's economy through a regional development plan called "Jing-Jin-Ji," short for Beijing, Tianjin, and Hebei ("Ji" is a one-character traditional name for the province). Endorsed by President Xi Jinping last year, it calls for expanding the network of roads and high-speed rail. Some government offices, as well as most of Beijing's wholesale markets in clothing and household goods, will be moved to Hebei to relieve congestion in the capital and create jobs in the province.

Earlier nationwide efforts to consolidate the steel industry foundered as local governments resisted closures that would have led to job losses and tax revenue shortfalls, says Komesaroff. The latest attempts may as well. "Our equipment is backward, and yes, we are polluting the skies, but we have maybe 30,000 workers—this factory is the biggest employer here," says a worker eating beef noodles in a cafe by the main gate of the Handan steel factory. His employer, a subsidiary of China's largest steelmaker, **Hebei Iron & Steel Group**, is ultimately controlled by the central government. "All of our revenues go to Beijing. They won't shut us down." —*Dexter Roberts*

The bottom line With the restructuring of the steel and cement industries, Hebei may lose at least 200,000 steel jobs.

Sanctions

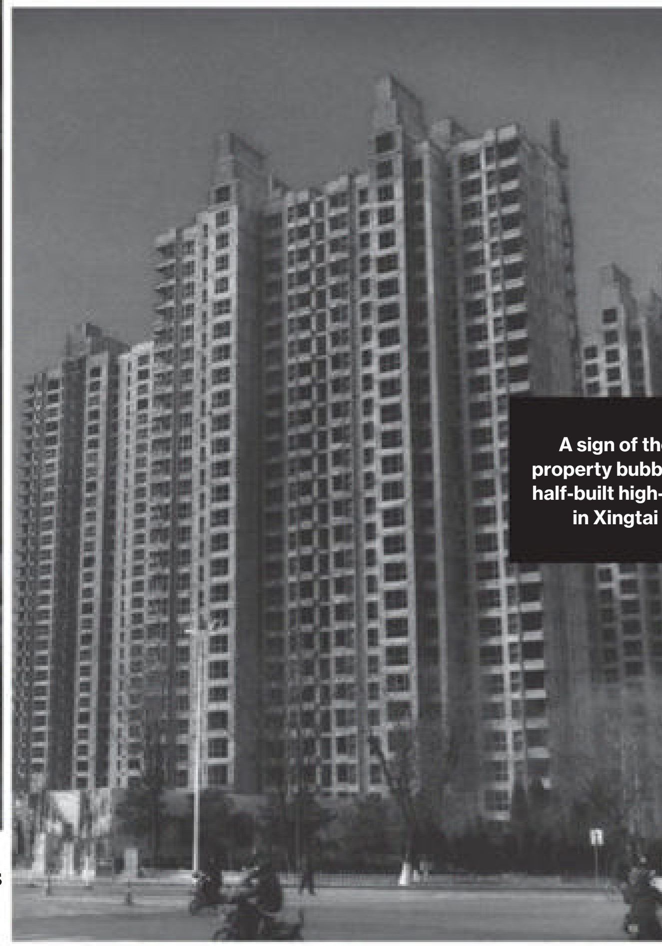
Crimea Feels the Pain of Joining Russia

▶ A punitive West and Ukraine's blockade are starving the economy

▶ "We're afraid. I have to feed my family"

Almost a year after Russia annexed Crimea, Moscow's liaison to the region, Oleg Saveliev, is struggling with a seemingly mundane task: paying bills. Before he flies to Crimea's capital, Simferopol, Saveliev packs wads of ruble notes

JAMES WHITLOW DELANO/BLOOMBERG BUSINESS (3)



A sign of the property bubble: a half-built high-rise in Xingtai

to pay for his hotel room. Even government ministers like him must pay cash. "It's astonishing," he says. Like many of Crimea's 2 million inhabitants, he blames Ukraine and its U.S. and European allies for runaway inflation and chronic shortages.

Since Russia seized the Black Sea peninsula and its residents voted overwhelmingly to split off from Ukraine, all foreign banks and many corporations have suspended operations. **Visa** and **MasterCard** stopped processing payments in December. Few Russian companies have moved in to fill the vacuum. That's because the U.S. and the European Union have threatened to impose penalties on businesses setting up shop in Crimea, says Nikolay Petrov, a political science professor at the Higher School of Economics in Moscow.

The cost of food is spiraling because it can no longer be trucked in from Ukraine, whose government refuses to recognize the redrawn border. Most supplies come via ferry from Russia. Bad weather can delay shipments for days. On the outskirts of Simferopol, at a supermarket owned by **Groupe Auchan** of France, the entire fresh meat department on a recent day consisted of three packages of beef.

Ukraine is also putting the squeeze on local agriculture, which employs 10 percent of the population. Kiev's move in April to sharply curtail water supplies through the North Crimean Canal left the peninsula with enough to irrigate only 12 percent of its farmland, according to the Association of Farmers and Landowners of Crimea. This forced most farmers to stop planting water-intensive crops such as rice and soya and switch to large-scale cultivation of sunflowers, which is more damaging to the soil, says Sergei Tur, the head of the association. "We're afraid," he says. "I have to feed my family."

The tourism industry—on which 1 in 3 Crimean families depend—has been devastated. The number of visitors fell by a third last year, to 4 million, local government data show. The overall decline would have been even steeper if Moscow hadn't undertaken a marketing campaign and subsidy program to encourage officials and employees of Russian state-owned companies to visit with their families, says Alexander Trofimov, head of the Association of Crimean Resorts. "A lot of people came for patriotic reasons," he says. Eighty percent of all tourists last year were Russians. Fewer may make the trip now that Ukraine has halted rail and bus service to Crimea through mainland Ukraine—the most economical and convenient ways to reach the peninsula.

Despite the hardships, 82 percent of Crimeans remain "fully" behind joining Russia, and more than half say they're better off financially because of it, according to a poll of 800 residents conducted by market researcher GfK Ukraine in the week ended on Jan. 22. After the referendum, Russian President Vladimir Putin moved to reward his new constituents by doubling pensions for about 560,000 retirees and salaries for 200,000 public workers. Skyrocketing prices are eating away at this dividend, however. And if the situation persists, the 681 billion rubles ($10.7 billion) the Russian government pledged through 2020 may not be enough to meet the region's needs, Saveliev says. *—Henry Meyer*

The bottom line Food shortages are stoking inflation, while tourism and agriculture—two of Crimea's mainstays—are suffering.

Edited by Christopher Power
Bloomberg.com

March 2 — March 8, 2015

The Pipeline Flows Again

▶ More new drugs are getting approved, but innovation carries a huge price tag

▶ "The costs are just so staggering, the health-care system cannot sustain it"

For decades, victims of advanced melanoma had few treatment options. Most died within a year from the virulent skin cancer. Now a new generation of biotech treatments—targeting proteins that allow cancer to evade the body's own defenses—is poised to change that. One new drug, **Bristol-Myers Squibb**'s Opdivo, boosted one-year survival rates in trials to 73 percent from 42 percent for standard chemotherapy.

There's one problem with Opdivo: It costs $150,000 a year per patient. It and dozens of other cancer drugs are problematic for insurers and employers who are being asked to foot the bill. More than 30 cancer drugs that hit the market from 2010 to 2014 cost $5,000 a month or more, according to data from Memorial Sloan Kettering Cancer Center in New York. **Express Scripts**, which administers prescription benefits for 85 million Americans, considers cancer treatment one of its cost control priorities.

A decade after Big Pharma worried that it wouldn't have enough drugs in the pipeline to maintain the costly research-driven business, the industry is enjoying a rush of expensive breakthrough medicines promising treatment for everything from rare cancers to hepatitis C. That's put the drug industry at odds with those picking up the tab for medical science's successes.

The conflict threatens to slow the pace of future discoveries and patients' access to the drugs. Pharma stocks have dropped when Express Scripts and other pharmacy benefit managers have decided to favor cheaper drugs over pricey ones. Express Scripts ignited a price war in December for hepatitis C drugs when it excluded a new drug from **Gilead Sciences** that cost more than $1,000 a day from its main list of covered drugs. Instead it favored a competing medicine from **AbbVie**, which offered significant discounts to get the business. "The costs are just so staggering, the health-care system cannot sustain it," says Steven Avey, vice president for specialty programs at MedImpact Healthcare Systems, a prescription benefits manager.

Leonard Schleifer, chief executive officer of **Regeneron Pharmaceuticals**, which is working on a cholesterol-fighting drug, sees it differently. "You are going to stop people from innovating" if coverage

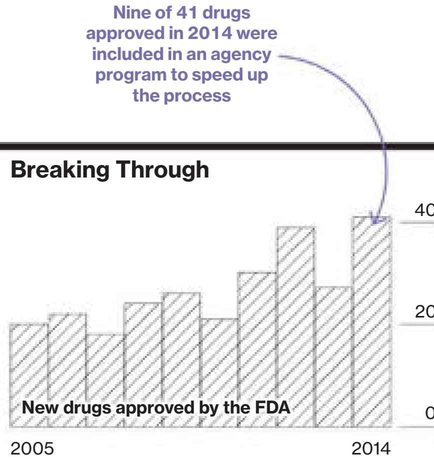
is limited to drugs with the lowest prices, he says.

Drug coverage is approaching a breaking point, says Stephen Schondelmeyer, a pharmacist and economist at the University of Minnesota, who's been following drug prices for decades. "We can cut prices, cut the drugs that are covered, or cut the number of beneficiaries, and none of those are very palatable," he says. "All mean reduced revenue for the drug companies. We will have to do one or more of those three things at some point in the next five years."

The 41 new drugs approved in 2014 by the U.S. Food and Drug Administration were the most in 18 years. Nine received expedited treatment as FDA-designated breakthroughs, including Opdivo, **Merck**'s rival melanoma treatment Keytruda, and two hepatitis C treatments: Gilead Sciences' Harvoni and AbbVie's Viekira Pak.

Scientific advances, more investment in biotech, and new FDA expediting policies are increasing the chances of more discoveries. Researchers at IMS Health, which tracks and sells prescription data, say about 30 to 35 drugs a year will come to market through 2018, vs. an average of 25 from 2000 to 2013. None of the closely watched cardiology drugs that Regeneron, its partner **Sanofi**, **Amgen**, and others are working on have gained FDA approval, but they've already triggered cost alarms. Known as PCSK9 inhibitors, the drugs aim to mimic the effects of genetic mutations discovered a decade ago that reduce heart disease risk by as much as 88 percent by lowering levels of LDL, the bad cholesterol. In testing, the new inhibitors cut LDL by 60 percent.

Breaking Through



DATA: U.S. FOOD AND DRUG ADMINISTRATION

CVS Health, the second-biggest drug benefits manager after Express Scripts, said in a blog post on Feb. 17 that some of the drugs are expected to be approved this year and stand to be "the highest selling class of medications in history," with annual sales as high as $150 billion, equal to about half of all current U.S. drug spending. "We will be attempting to address this with every approach that pharmacy benefit managers use," says Troyen Brennan, CVS's chief medical officer. Express Scripts has said it's considering all the options for how to cover the PCSK9 drugs and hasn't ruled out restricting coverage to just one of the drugs to get a discount. CVS says they will cost an estimated $7,000 to $12,000 a year, or as much as 60 times more than the generic statins that are typically prescribed to fight cholesterol.

Executives who get too aggressive with pricing risk big stock drops—and their jobs. Sanofi shares fell the most in 15 years on Oct. 28, when it said sales of its diabetes drugs would be little changed this year because it had to cut prices of its Lantus insulin medicine to stay on benefit managers' lists. CEO Chris Viehbacher, who had clashed with Sanofi's board over other issues, was ousted the next day. Express Scripts dropped **GlaxoSmithKline**'s asthma drug Advair from its main list of covered drugs in 2014 over pricing issues. U.S. sales of the drug fell 25 percent. Advair made it back onto the list this year after Glaxo lowered the price, according to Express Scripts spokesman David Whitrap. Still, sales of Glaxo's U.S. drugs and vaccines slumped 10 percent in 2014.

So far, the payer backlash isn't reversing the expensive trend. The average price of more than 5,000 commonly used prescription medicines rose 11 percent last year, a rate 14 times higher than that of U.S. consumer inflation, according to Truveris, a maker of software that analyzes prescription drug prices and benefits. IMS sees prescription spending in the U.S. growing to about $450 billion in 2018, from $329 billion in 2013.

In Europe, drug companies have long had to negotiate drug prices with governments. Since the financial crisis, pressures to keep prices down have increased. The U.K. has a state-run agency that advises its National Health Service on which treatments represent value for money.

"There is a lot of innovation on one hand, but the U.S. market is getting more challenging and more price-competitive," says David Redfern, chief strategy officer for GlaxoSmithKline. "It's not only one or two therapy areas; it's clearly moving out to other therapy areas." While the total number of applications to the FDA isn't going up, the medicines the agency reviews "are much more effective than we have seen in the past," says John Jenkins, director of the FDA's office of new drugs. Forty-four percent of drugs approved in the last three years are totally new classes of medicines, the agency says, vs. 27 percent from 1987 to 2001.

> **"We can cut prices, cut the drugs that are covered, or cut the number of beneficiaries, and none of those are very palatable."**
> **—*Stephen Schondelmeyer***

Jenkins cites Cosentyx, a psoriasis drug from **Novartis**, as an example of how effective new, targeted biotech drugs can be. In human tests, the drug almost completely cleared signs of psoriasis in most patients. The drug, which was recently approved, is likely to be priced similarly to other psoriasis drugs costing $30,000 a year or more, says David Epstein, head of Novartis's pharmaceuticals unit. But he says he's prepared for a ▶

ILLUSTRATION BY 731

price war when drugs from Amgen, its partner **AstraZeneca**, and **Eli Lilly** hit the market.

In cancer, "it wasn't that long ago" that the FDA was being asked to approve drugs that shrank tumors in only 10 percent to 15 percent of patients, the FDA's Jenkins says. "Now we are seeing drugs with a 50 to 60 to 70 percent response rate." The pricing pressure is aggressive and challenging, according to Glaxo's Redfern.

"From a scientific standpoint, it has never been a more exciting time," says Steve Miller, chief medical officer of Express Scripts. "But how are you going to pay for it?" —*Robert Langreth and Oliver Staley*

The bottom line Drugmakers are enjoying a rush of new medicines, but their high costs threaten the pace of innovation.

Marketing

Brazil's *Favela* Bars Upgrade on Ambev's Tab

▶ By cleaning up dives, Ambev and owners hope to increase sales

▶ "I've had to go and buy the beer myself at the store"

Bar owner Alexandre Nunes paid **Ambev**, Latin America's biggest brewer, about $3,500 two years ago to help him turn his dank bar for hard-core drinkers into a clean establishment that attracts lower- and middle-class families. Nunes turned a profit almost immediately, he says, and after about six months revenue grew 60 percent. Now he plans to overhaul another inhospitable dive with Ambev's help. "In one month we started seeing a change, and sometimes now we even have a waiting list," he says. "We're making money. We've hired more workers. Things are going really well."

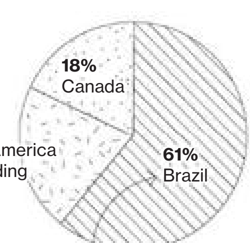
Nunes is part of Ambev's Our Bar franchise program, which seeks to lift sales by targeting entrepreneurs in Brazil's slums, known as *favelas*. The company helps spruce up taverns and offers management training. It's joining retailers and other businesses trying to reach out to the new middle class in Brazil's gritty neighborhoods in and around its big cities.

About 1,000 bars in Rio de Janeiro and São Paulo are part of Ambev's program. The brewer, a unit of Anheuser-Busch InBev, the world's biggest beer company, has pronounced the program a success and says thousands more bars will join. Ambev controls almost 70 percent of Brazil's beer market. Total revenue for 2014 is estimated to reach 38 billion reais ($13 billion), 9 percent more than 2013. "The Our Bar network stimulates Brazilian entrepreneurs and is a tool to improve the quality of life of the small-business owner," says Alberto de Souza Filho, Ambev's corporate manager of franchises.

Introducing brand names into Brazil's favelas means confronting stubborn poverty. About 6 percent of Brazil's population lived in favelas as of 2010, according to the government. The slums, which lack public services, persist after a decade in which Brazil's new middle class–with annual household income from about $8,000 to $15,000–surged by two-thirds, to almost 113 million people. Brazilian banks have put ATMs in the favelas, and retailers such as **Casas Bahia** and **Ricardo Eletro**, which sell electronics and appliances, have moved in. These are exceptions–most stores and restaurants in the shantytowns are informal businesses. Bars typically are dirty, inefficient, and unwelcoming to women.

Bar owners invest an average of 28,000 reais and pay a monthly fee of as much as 600 reais, according to Ambev's website. In return the company provides financing for renovations, marketing, and training, as well as equipment and furniture. A more upscale franchise with an initial investment starting at 500,000 reais, called *Seu Boteco* or Your Bar, has wooden furniture and large ▶ 24

Ambev on Tap
3Q 2014 beer sales



$1.9b

COURTESY AMBEV; DATA: COMPILED BY BLOOMBERG


Vegas means business.
The average Las Vegas trade show delegate spends more time on the floor. To be exact, 11 hours here vs. 6.3 to 9.4 hours in other cities. With world-class meeting facilities, an extensive range of hotel rooms, and a city unrivaled in event and convention experience, here, business as usual is better than usual. Find out all the reasons why so many FORTUNE 500® companies choose Las Vegas.
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LAS Vegas
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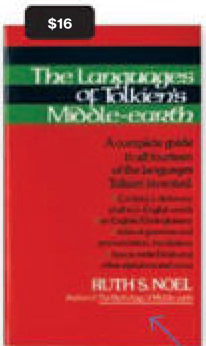
Geek Speak 101

Most letters are pronounced as they are in English

$16



J.R.R. Tolkien, author-creator of Elvish, was a philologist by profession

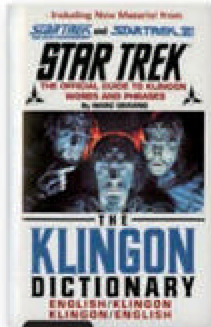
Elvish

My heart sings to see thee.
Cormamin lindua ele lle.

May your ways be green and golden.
Aa' menealle nauva calen ar' malta.

I love to see your eyes shine when you laugh.
Gellon ned i galar i chent gîn ned i gladhog.

You did well.
Lle ume quel.



$16

Klingon

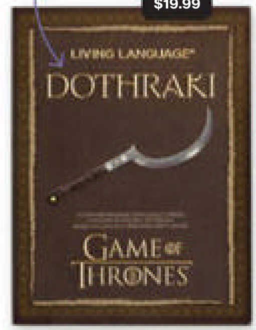
What do you want?
nuqneH?

Where do you keep the chocolate?
nuqDaq yuch Dapol?

You look terrible.
bImoHqu'.

When will the water be hot?
ghorgh tujchoHpu' bIQ?

$19.99



Dothraki

Hello!
M'athchomaroon!

Taste this mare's milk.
Lekhis jin lamekh.

Don't tie that horse down.
Vo liwos haz hrazef.

A prince rides inside me!
Khalakka dothrae mr'anha!

Let's ride!
Dothralates!

◀ windows to create the atmosphere of a sidewalk bar in Rio de Janeiro, says Ambev's website. The aim is to draw higher-income patrons, who'd buy more of Ambev's premium brands, such as Budweiser.

Some bar owners say their renovated bars have drawn more customers. Others say that Ambev imposes too many restrictions. Our Bar owners can serve only Ambev beers, such as Budweiser, Corona, and Skol. The company doesn't allow owners participating in the program to serve Coca-Cola, because Ambev bottles and distributes Pepsi in Brazil.

Francisco Nunes, no relation to Alexandre, signed an Our Bar deal last year. He says Ambev's deliveries of beer and soda to his Rio de Janeiro bar haven't been dependable since September, and the company isn't responding to his calls. "There have been so many times that I've had to go and buy the beer myself at the store, or else I'd have nothing to offer," he says. He's considering getting out of his contract early, which carries a 25,000-reai cancellation fee. Ambev in an e-mail wrote that it guarantees supplies depending on the availability of the product and that deliveries in Brazil have been "occurring normally."

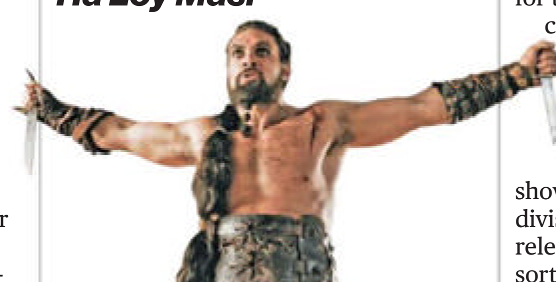
Marcos Antonio de Oliveira says sales at his São Paulo bar, located near a soccer stadium built for last year's World Cup tournament, quickly doubled to about $28,000 a month after he paid $4,600 for the Our Bar franchise in 2013. Some of that revenue was because of increasing enrollment at a nearby medical school. Business has stagnated since just before the soccer championship. Competitors have copied the Our Bar style, de Oliveira says—cleaning up their bars, installing red signage, and trimming tables with decals—without paying franchise fees.

"At first, being a franchise differentiated us," he says. "All of the neighborhood bars are red now. I need to do something to stand out again." —*Christiana Sciaudone*

The bottom line Hoping to tap into Brazil's growing middle class, Ambev has helped fix up about 1,000 bars.

Pop Culture

*Nesos Tiholat Jin, Ha Loy Masi**



▶ *Game of Thrones*' Dothraki isn't on any college curriculum—yet

▶ "I needed something crazy to do because I'm bored"

On the continent of Essos, a nomadic people live on steppeland so boundless the expanse is a veritable ocean. It carries the nomads' name, the Dothraki Sea. To cross this terrain to raid their enemies, the Dothraki use horses—as both transport and food for their warriors. Dothraki is derived from the word for "rider," and the language has more than 30 words for horse and horse products: *nerro*, *lame*, *chafi*, *jedda*, *sajo*, *vezh*, *manin*.... Fresh horse meat is *gavat*; the dried variety is *zhifikh*. Fermented mare's milk is *lamekh*. The main word for horse itself is *hrazef*. And there are hrazefs of different colors—*cheyao*, *ocha*, *qhalan*, *messhih*.

Whoa! (*Affa* in Dothraki.) If you are wondering what cosmos you've stumbled into, you aren't one of the countless fans hooked on the violent, lascivious, melodramatic, completely addictive alternate universe in HBO's four-year-old hit series, *Game of Thrones*. (It drew more than 19 million viewers a week during its 10-episode season last spring; Season 5 comes in April.) In 2009, David Peterson, co-founder of the Language Creation Society, invented new Dothraki words for the show's pilot after winning a contest for the gig. He's since started a blog where he discusses the language and how it's taken on a life of its own. And for aficionados who already have a smattering of Dothraki from watching the show, Peterson and Living Language—a division of **Random House**—recently released a book-and-CD set ($19.99), a sort of immersion course on the language and culture of the nomads and their friends, enemies, and horses.

Dothraki isn't likely to be on the curriculum at any college, but a small coterie of fans has emerged to talk up the language. Peterson hosts regular online conversations with devotees to discuss the finer points of Dothraki grammar. Tim Stoffel, a 54-year-old broadcast engineer from Reno, Nev., manages Dothraki.org, a website that offers lessons in both Dothraki and another *Game of Thrones* tongue, High Valyrian. He says he can carry on a conversation in Dothraki—he's one of the few. My "interest is almost more scholarly than being a conversational speaker," he explains.

The vocabulary, currently about 2,000 words, is extensive enough for

*Learn to Understand This, for Some Treasure

CLOCKWISE FROM LEFT: HELEN SLOAN/HBO/EVERETT COLLECTION; ILLUSTRATION BY 731; SCOTT EELLS/BLOOMBERG

people to have a simple conversation. More words are on their way—Peterson's always working to improve and expand Dothraki. The *Game of Thrones* subculture emerged in a big way only after the HBO show premiered in April 2011, inspired by a series of books by George R.R. Martin. The Living Language volume that Peterson put together is a slim textbook. It has six chapters devoted to the nuts and bolts and includes basic expressions such as "How are you?" (*Hash yer dothrae chek?*; literally, "Do you ride well?"); "I'm fine" (*Anha dothrak chek*; literally, "I ride well"); and "Be cool!" (*Dothras chek*; literally, "Ride well").

Fans who think that learning a language (old or invented) is too much of a chore can indulge in other aspects of *Game of Thrones* consumerism: scooping up branded clothes, jewelry, cookbooks, and toys. HBO's online store carries more than 350 *Game of Thrones*-related items, and a search on **Amazon.com** brings up more than 18,000 results in the clothing, shoes, and jewelry section alone. In 2012 there was a surge in the number of babies named after two principal characters from the series—Khaleesi and Arya.

Ben Wood studies linguistics at Cal State Fullerton and spends his days trying to revitalize Native American languages before they die out. He speaks five languages besides English, including German. "I grew up hearing German because my mom is from Germany, and I can speak German without an accent," he says. "I knew Dothraki existed for several years, but it never interested me until a couple of months ago. I thought I needed something crazy to do because I'm bored, so I might as well learn it and play with it a little."

There may have been another inspiration. When Wood recently posted a video of himself speaking Dothraki on YouTube, the person he delighted the most was his mother. She's a *Game of Thrones* loyalist. At the end of a good Dothraki conversation, she'd likely exclaim: *Dothralates!* "Let's ride!"
—*Lucas Shaw*

The bottom line There is a growing alternative universe of linguists drawn to a language invented for HBO's *Game of Thrones*.

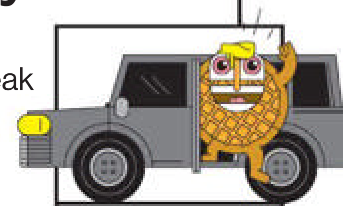
Edited by Dimitra Kessenides
Bloomberg.com

Briefs

By Kyle Stock

Turning Money Away

JPMorgan Chase dismissed calls to break up the banking and financial-services firm, while laying out a plan to streamline operations. CEO Jamie Dimon, speaking at an annual investor day on Feb. 24, said the company would close 300 bank branches, or about 5 percent of its locations, by the end of next year. It will also reduce deposits from corporations, hedge funds, and foreign banks by about $100 billion. Dimon said low interest rates and rising compliance costs make holding that money an unattractive business. Everything's still awesome at *Lego*. The privately held toymaker said profits surged 15 percent, to $1.1 billion, last year, thanks in part to sales related to *The Lego Movie*. It said toys linked to the *Star Wars* film coming in December and Lego Elves, a line of characters aimed at girls, could keep up the momentum in 2015. *Honda* CEO Takanobu Ito said he will step down after a six-year tenure marred by massive recalls and flaws in air bags made by Takata. His successor, Takahiro Hachigo, is a senior official in Honda's R&D department. *Southwest Airlines* failed to perform mandatory inspections on 128 of its Boeing 737 jets, or roughly one-fifth of its fleet. After the airline flagged the problem to regulators on Feb. 24, the Federal Aviation Administration allowed the jets to keep flying for as long as five days to preclude cancellations on Southwest's 3,400 daily routes. *Martin Aircraft*, the maker of $200,000 jetpacks, had a shaky IPO. After soaring 50 percent, shares swooned and finished their first day of trading up just 10 percent. The New Zealand company likens its products to "motorcycles in the sky" and is producing a model for first responders.



Waffle House, a chain of 1,750 diners, has struck an agreement to use its restaurants to receive, hold, and distribute packages for Roadie, a startup that describes itself as the Uber of shipping.

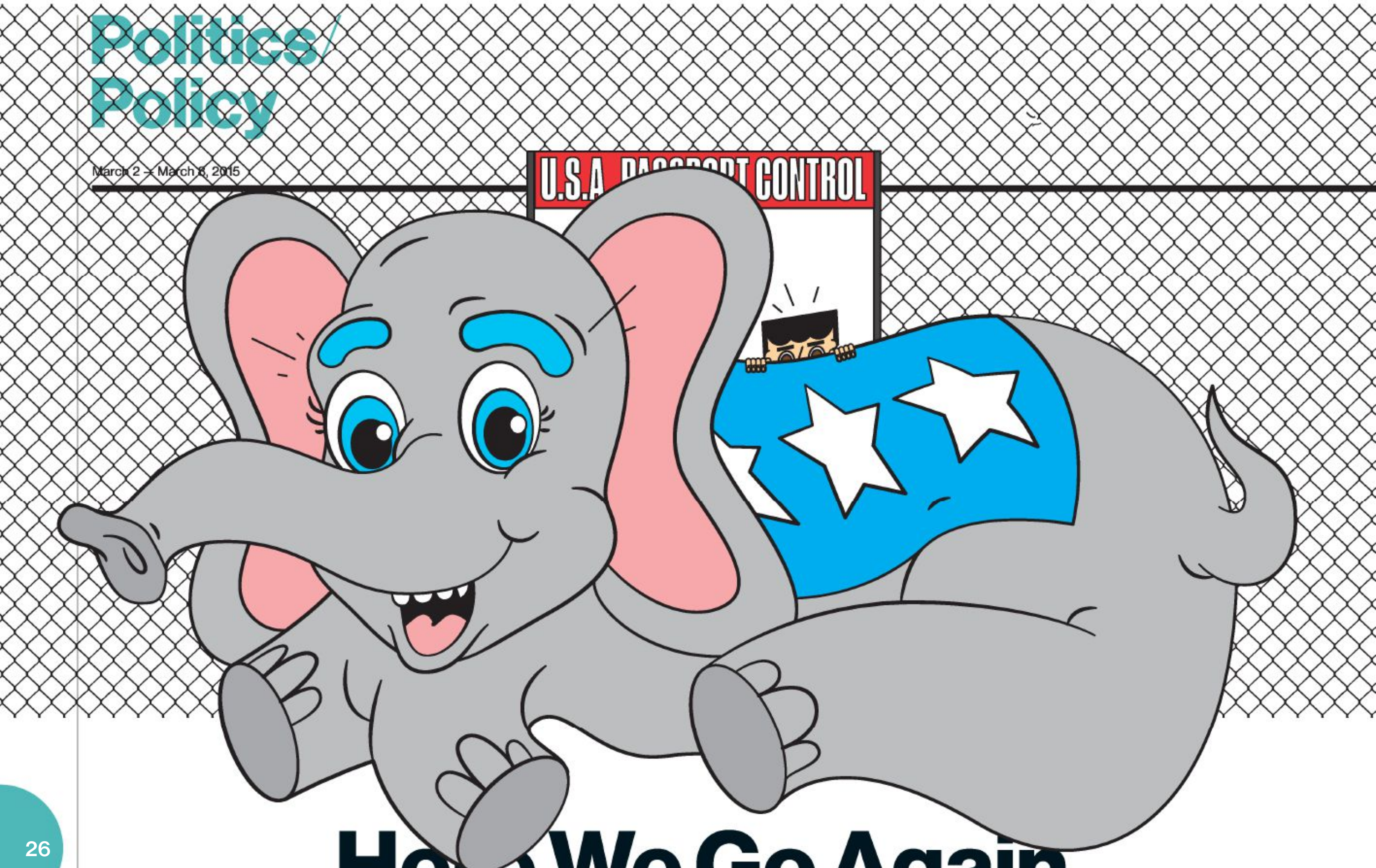
$778m

Uniform sponsorship revenue for Europe's top six soccer leagues in the current season, ending this spring. The total is up 24 percent from the previous year, according to Repucom.

CEO Wisdom

"Not every year in this century is going to be China's year, even if it turns out to be their century."

—**Lloyd Blankfein**, CEO, Goldman Sachs



Here We Go Again

▶ Why blocking Obama on immigration may be a smart strategy for Republicans in Congress

▶ "Even the 'good' Republicans are going along"

For the third time in as many years, congressional Republicans find themselves threatening to shut down part of the federal government rather than compromise with the White House. The latest fight, over President Obama's decision to stop the U.S. Department of Homeland Security from deporting millions of undocumented immigrants, has upset potential GOP presidential candidates, several of whom have made it a priority to attract Latino voters. "For God's sakes, don't shut down the premier homeland security defense line," Senator Lindsey Graham of South Carolina said in a Feb. 23 appearance on *Fox & Friends*. "If we do, as Republicans, we'll get blamed."

Graham's comments echoed a plea made by Karl Rove, the party's senior strategist, in the *Wall Street Journal*. "The argument has always been about the prudence of tactics, not about goals," he wrote. But the same strong-arm tactics that Rove says are bad for the GOP's chances of winning the White House in 2016 may be good for some politicians on the Hill. While the national electorate crucial to winning presidential elections is becoming younger and more diverse, the voter base of many congressional Republicans remains overwhelmingly old, white, and male.

Republicans have worked to consolidate and amplify the power of that constituency. After the 2010 census, GOP-controlled state legislatures around the country redrew many congressional districts to make them whiter and more conservative, creating an estimated 200 safe Republican seats. "If you're a House member in a bleached district, even if you're in a diverse state, your tendency is to look over your right shoulder for a Tea Party challenger rather than worry about the nonwhite vote," says Frank Sharry, executive director of the immigrant advocacy group America's Voice.

Senate Republicans face a similar calculus, even without doctored districts. Today, minorities make up the majority of the population in only four states: California, Hawaii, New Mexico, and Texas. That number won't double for more than a decade, and it won't be until 2052 that minorities make up a majority of eligible voters across the U.S., according to a Feb. 24 report jointly sponsored by the conservative American Enterprise Institute, the liberal Center for American Progress, and the nonpartisan Brookings Institution. White voters, who tend to be older, still vote at higher rates than minority voters: In 2012 white turnout was 64 percent, vs. 48 percent for Latino voters.

After Mitt Romney lost the 2012 election, taking only 27 percent of the Latino vote, the Republican National Committee invested in a $10 million plan to boost Latino outreach. Former Florida Governor Jeb Bush, who's exploring a presidential run and whose

ILLUSTRATION BY 731; STEVE KEENAN/THE REGISTER-HERALD/AP PHOTO

Alabama gets religion on payday lending 28

The Republican who loves Rahm 29

wife is from Mexico, last year called illegal immigration "an act of love" by parents seeking a better life for their children. In February he called on the president and Congress to find a "common-sense immigration solution." Florida Senator Marco Rubio, another possible contender, spearheaded the Senate's failed 2013 effort to create a pathway to citizenship for immigrants who have lived in the U.S. for years without papers.

The immigration issue has splintered Republican advocacy and donor groups. Business groups including the U.S. Chamber of Commerce have lobbied for an immigration overhaul, while Heritage Action for America, the political arm of the Heritage Foundation think tank, has opposed concessions that would allow undocumented immigrants to remain in the U.S. without punishment, describing it as amnesty.

In January, Iowa's Steve King successfully championed a Homeland Security funding bill overruling not only Obama's November decision to shield the parents of children born in the U.S. from deportation but also a 2012 directive from the administration protecting young adults who came to the U.S. as children. After persuading House Majority Leader Kevin McCarthy to put forward the legislation, King—who in 2013 characterized immigrants crossing the southern border with Mexico as drug runners with "calves the size of cantaloupes"—emerged with a grin from McCarthy's Capitol office.

When Democrats in the Senate blocked passage of similar legislation, House Speaker John Boehner, who promised to use his expanded majority to undermine Obama's immigration action, proposed a $10 billion Homeland Security bill that paid for border enforcement, including drones, radar, and biometric tracking systems. It didn't include provisions for addressing the problem of undocumented immigrants already living in the U.S. The goal, Boehner said in a Jan. 27 news conference, was to "show the American people that we're here to listen to their priorities."

That effort also failed, even though Republicans in both chambers—including Senator John McCain of Arizona, who in 2013 championed giving immigrants a path to citizenship—lined up behind the measure. "Even the 'good' Republicans are going along," says Alex Nowrasteh, an immigration policy analyst at the libertarian Cato Institute. Republican leaders "think this will just placate the anti-immigration reform crowd enough that they'll be able to do what they want on immigration reform," he says. "Nothing will placate them, and they're being foolish thinking that it will."

"If you're a House member in a bleached district ... your tendency is to look over your right shoulder for a Tea Party challenger."
—Frank Sharry

The impasse on Capitol Hill set up the last-minute scramble to reach an accord before funding for Homeland Security was due to run out on Feb. 27. Now party leaders are on the record trying "to separate families and deport kids brought here through no fault of their own," says Hector Barajas, a Republican strategist from California. "That negative message is one that the community will remember. I'm afraid it's taking us back in a way that we will lose another generation of voters." —*Heidi Przybyla*

The bottom line GOP presidential candidates worry the party is losing the Latino vote, but many congressional Republicans don't care.

Energy

Who's to Blame for the Exploding Oil Trains?

▶ **Railroads and oil companies bicker over the cost of new rules**

▶ **"All the stakeholders ... are aggressive in protecting their turf"**

A week after a **CSX** train hauling crude oil derailed and exploded 30 miles southeast of Charleston, W.Va., on Feb. 16, its mangled, charred tank cars were still being hauled from the crash site. Of the 27 cars that derailed, 19 had been engulfed in flames. The wreckage burned for almost three days. "It's amazing no one was killed," says John Whitt, whose home is one of a handful clustered near the crash site, along the banks of the Kanawha River. Some were within 30 yards of the site. One home was destroyed.

Exploding oil trains—this was only the latest in a series—have emerged as a dangerous side effect of the U.S. energy boom. A lack of pipelines connecting new fields in North Dakota and Texas to refineries and shipping terminals has led to an almost 5,000 percent increase in the amount of oil moved by trains since 2009. Much of it is carried in tank cars designed a half-century ago that regulators have long deemed inadequate for hauling the highly flammable types of crude coming out of North Dakota.

The West Virginia accident came less than a month after the U.S. Department of Transportation sent a proposal for new safety standards to the White House for approval. The rules were supposed to have been submitted at the end of last year but were delayed amid lobbying from railroads, oil producers, and tank car manufacturers. Part of the problem has been crafting regulation that's broad enough to address a range of safety issues—including speed limits, braking systems, and track maintenance—but that can also withstand potential legal challenges from the affected industries. "All the stakeholders have their opinions, and they are aggressive in protecting their turf," says Joe Szabo, who stepped down as head of the Federal Railroad Administration in January.

The Feb. 16 explosion near Mount Carbon, W.Va.

The type of tanker involved in the West Virginia incident has been built since 2011. Outfitted with a reinforced body and tougher valves, to keep oil from leaking during a wreck, the CPC-1232 was supposed to be an improvement on the tank car designed in the 1960s that's still prevalent on the tracks today.

The Transportation Department is pressing the industry to make further improvements. Under the latest version of the draft regulation, tank cars would have to have even thicker shells and better brakes and valves. Even then, analysts say, risks will remain. "You could make tank cars resemble Army tanks, and it still isn't going to stop accidents," says Brigham McCown, a ▶

former administrator at the Pipeline and Hazardous Materials Safety Administration. Last summer the Transportation Department predicted that trains hauling crude or ethanol could derail 10 times a year over the next 20 years, causing $4.5 billion in damage.

Despite those forecasts, the industry's lobbyists appear to have extracted some concessions. U.S. regulators had initially called for a two-year phaseout of oil tank cars—both the old and the improved version. The revised proposal maintains the phaseout schedule for the old cars but extends the deadline for some of the newer tankers to as long as a decade, according to three people familiar with the document who weren't authorized to speak on the record. Executives from the Railway Supply Institute, a trade group representing companies that make tank cars, argued there isn't enough manufacturing capacity to turn over the fleet in a couple of years. The institute's president, Tom Simpson, says too aggressive a deadline would force oil producers to dial down production or move more of their crude in trucks, which come with their own safety hazards: "The option is we don't have it, or we use highways."

$13.6b

Cost of new oil tank car regulations in their first year, as projected by a rail industry trade group

Sarah Feinberg, the acting administrator of the Federal Railroad Administration, says the rule-making process has been slow because of the need to craft comprehensive regulations that go beyond mandating new tank cars. "A new tank car is not a silver bullet," she says. "If the product you put into transport is safer, then a lot of these other issues are easier to solve."

Under regulations adopted last year, oil companies in North Dakota will have to remove volatile gases such as propane from their crude before pumping it into a rail car, starting in April. According to the North Dakota Department of Mineral Resources, that will raise costs by an estimated 10¢ per barrel for the energy industry, which says it's already bearing too much of the burden of tougher regulation. Based on the draft proposed last summer, the Railway Supply Institute has estimated the new safety requirements for tank cars would add about $13.6 billion in shipping costs in the first year; oil companies and refiners anticipate they will foot some of the tab in the form of higher lease rates for rail cars. "It's time we focused attention on the root cause of the problem and get the railroads to keep their trains on the tracks," says Charlie Drevna, president of the American Fuel & Petrochemical Manufacturers.

It will likely be months before the cause of the West Virginia crash is known. One thing that doesn't appear to be an issue is speed. The train was traveling at only 33 mph, below the speed limit of 50 mph. Jim Hall, former National Transportation Safety Board chairman, would like to see the trains go even slower. "We don't have short-term adequate protection to prevent these events other than slowing the trains down," he says. —*Jim Snyder and Matthew Philips*

The bottom line The latest oil train explosion raises questions about how effective proposed rule changes would be in reducing disasters.

Credit

On Payday Loans, Churches Ask, "WWJD?"

▶ Alabama's Baptists get behind a lobbying push for rate caps

▶ Jesus "wanted people to make a good living, just not take advantage"

On a single mile of the Atlanta Highway in Montgomery, Ala., more than a dozen stores offer short-term payday loans. Easy Money, Always Money, TitleBucks: The names are different, but the business is the same. The lenders offer borrowers cash secured by a postdated check or car title. In Alabama, payday loan interest rates can go as high as 456 percent, among the highest in the country, and about 35 times the average for fixed-rate credit cards. On car title loans, Alabama lenders charge as much as 300 percent.

In November the Alabama Baptist Convention, which has 3,200 member churches with 1.1 million congregants—more than 20 percent of the state's population—passed a resolution calling for curbs on payday lending. They joined the state's United Methodist Church conventions, which passed their own resolutions in 2014. Now church leaders are pushing congregants to lobby lawmakers when the state legislative session opens in March, to pass an interest rate cap of 36 percent on payday and title loans. "Jesus was for profit," says Travis Coleman Jr., president of the Alabama Baptist Convention, who worked as a bill collector in college. "He wanted people to make a good living, just not take advantage of the poor."

The question is whether pastoral outrage can overcome "institutionalized, well-organized money," says Stephen Stetson, an analyst at Alabama Arise Citizens' Policy Project, which works on behalf of low-income people. Lenders have hired more than 20 lobbyists, says Shay Farley, legal director for the Alabama Appleseed Center for Law & Justice in Montgomery, another group advocating for the poor. Industry groups and lenders such as **Advance America Cash Advance Centers** and **TitleMax** have given more than $300,000 in campaign contributions to lawmakers and political committees since 2013, Alabama secretary of state records show.

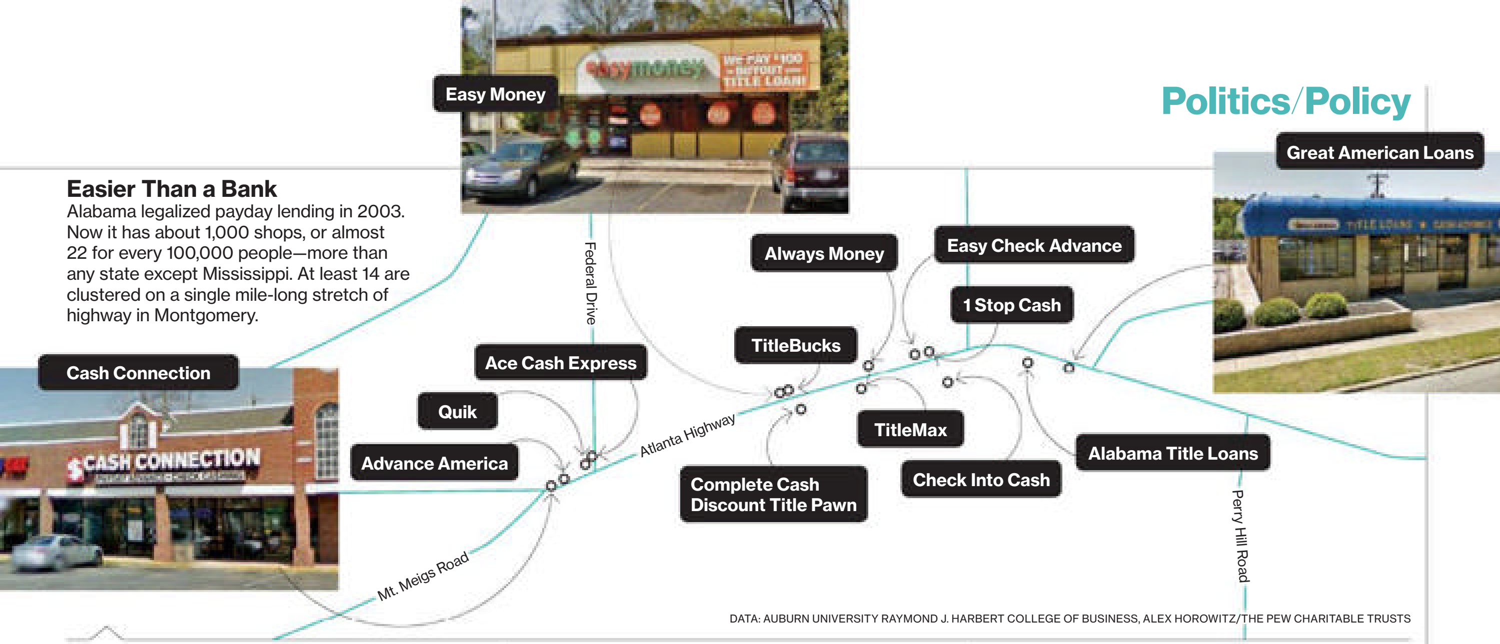
"I don't think the churches deserve to have any larger voice than the millions of consumers who use the

Quoted

"We have the same options available to us to whack them, do whatever you want, as we have today."

Secretary of State **John Kerry**, answering questions from senators on Feb. 24 about how to guarantee Iran doesn't develop nuclear weapons if a deal is reached

FROM LEFT: WIN MCNAMEE/GETTY IMAGES; COURTESY GOOGLE MAPS (3)



Easier Than a Bank
Alabama legalized payday lending in 2003. Now it has about 1,000 shops, or almost 22 for every 100,000 people—more than any state except Mississippi. At least 14 are clustered on a single mile-long stretch of highway in Montgomery.

DATA: AUBURN UNIVERSITY RAYMOND J. HARBERT COLLEGE OF BUSINESS, ALEX HOROWITZ/THE PEW CHARITABLE TRUSTS

product," says Ted Saunders, chairman and chief executive officer of Ohio-based **Community Choice Financial**, which operates 600 stores in 15 states, including Alabama.

Caterer Fred Cobb of Birmingham stopped at **Title Cash** in suburban Center Point recently to pay interest on a loan backed by his truck. Cobb says he uses the money to buy barbecue meat, then repays it after he gets paid by clients. It's easier than going to a bank, he says: "I can come in here and leave with $300 in 30 minutes or less."

The House version of the 2003 law that permitted payday lenders to open in Alabama would have required them to help enforce a borrowing limit of $500 per person by submitting transactions to a single statewide database. The Senate version of the bill added a loophole that allowed borrowers to easily take out loans exceeding the limit. The lenders "were able to do it as a result of the same old routine down there: well-placed influence," says former state Representative Jeff McLaughlin, a Democrat who opposed the legalization of payday lending. In 2013, when John Harrison, the state's banking superintendent, moved to revive the idea of a unified borrower database, lenders sued. The case is pending before Alabama's Supreme Court.

Republican Representative Mike Hill, who sponsored the 2003 bill and sits on the Alabama House Financial Services Committee, says the churches face an uphill battle persuading Republicans, who control the statehouse, to pass rate caps this year. Coleman, who serves as senior minister at First Baptist Church in Prattville, outside Montgomery, says the churches have numbers on their side: Almost two-thirds of Alabamians attend church regularly, behind only Utah and North Dakota, according to the Association of Religion Data Archives. "I've seen what church people can do when they understand the issue and get behind it," he says. —*Mark Niquette*

The bottom line Churches in Alabama are organizing to oppose payday loans, which can have interest rates as high as 456 percent.

Campaign Finance

The Money Man Behind Mitt, Jeb—and Rahm

▶ A Chicago donor raised millions to oust Obama but supports Emanuel

▶ He "is putting his money where his desires are"

Chicago investor Muneer Satter has spent more than $1 million in the last three years helping Republicans win elections across the country. He also spent more than $352,000 trying to make sure Rahm Emanuel, one of the most prominent Democrats in the country, would keep his job as Chicago's mayor. Emanuel failed to win a majority in the Feb. 24 election and now faces a runoff in April.

According to the Illinois State Board of Elections, Satter and his wife, Kristen Hertel, are among Emanuel's top donors, despite having spent heavily in 2012 trying to oust President Obama, Emanuel's former boss. The mayor was White House chief of staff until October 2010, when he returned to Chicago to run for office. "In Chicago, as everywhere, leadership is everything," says Lisa Wagner, Satter's spokeswoman. "Muneer looked at all of the candidates in the mayor's race, and Rahm was the only candidate who could effectively tackle the problems of our city."

Satter, 54, began giving to Emanuel in 2007. At the time, Emanuel represented a Chicago-area district in Congress. Satter, a former partner at Goldman Sachs, worked in New York, but his wife, a former commercial banker, and five daughters stayed in Winnetka, a North Chicago suburb. In 2010, Hertel was among the first contributors to Emanuel's mayoral campaign. Satter "wants to see the best person win and is putting his money where his desires are," says Ronald Gidwitz, another Illinois Republican donor.

Satter retired from Goldman in 2012. A longtime supporter of Mitt Romney's presidential ambitions, Satter raised money for his failed 2008 bid. During the second Romney run, Satter and Hertel pumped $885,000 into Restore Our Future, American Crossroads, and other super PACs, Federal Election Commission reports show. Satter also raised more than $25 million for Romney's campaign and related groups from Illinois donors.

Now Satter is all in for former Florida Governor Jeb Bush. Satter sat with Bush's wife, Columba, during a February appearance Bush made at the Chicago Council on Global Affairs. "He believes Governor Bush is the one who is most ready to assume the Oval Office and would be outstanding if elected president," Wagner says. —*Julie Bykowicz*

The bottom line Muneer Satter backs Republicans for national office, but in Chicago, he's become a major donor to Rahm Emanuel.

Edited by Allison Hoffman
Bloomberg.com


ACCESSING
EGYPT THE FUTURE
KEY GEOGRAPHICAL LOCATION
LINKING THREE CONTINENTS
Join world leaders and the international investment community in shaping an unprecedented plan for Egypt's prosperity.
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March 2 — March 8, 2015

Too Good to Be Legal

▶ Clean and simple, Popcorn Time makes piracy easier than ever

▶ "The amount of attention this project has been receiving is HUGE"

For more than a decade, pirating a movie or TV show using BitTorrent, the Internet's notorious file-sharing protocol, required a modicum of work and technical ability. You had to use a clunky program specially designed to seek out and decode pirated files, then learn to refine its search tools to find the videos you wanted. Annoying banner ads within the search program were part of the deal, as was occasional malware. Pirating wasn't just a pain for the Hollywood studios whose products were being passed freely around the Web; it was a pain for unscrupulous seekers of free video, too.

In the past year, a program called Popcorn Time has become the kinder, gentler face of piracy online, taming BitTorrent to make it far more user-friendly and less obviously sketchy. Free incarnations for PCs, phones, and tablets look pretty much like **Netflix**, **Hulu**, or **Amazon** Instant Video, except with vastly deeper catalogs that include theatrical releases such as Oscar winner *Birdman* and with little to no advertising. Those benefits have raised fresh concern in Hollywood and Silicon Valley. Although it's difficult to estimate total viewership of a pirate service, in Netflix's latest annual report to shareholders Chief Executive Officer Reed Hastings and Chief Financial Officer David Wells named Popcorn Time a major worry. The sharp rise of Google searches for Popcorn Time, Hastings and Wells wrote, is "sobering."

Netflix's Jan. 20 report included a chart showing that about as many people in the Netherlands search Google for Popcorn Time, which made its debut in March 2014, as for Netflix or **HBO**. As of Feb. 25, Google data show similar results for Italy, Portugal, and Spain. ▶

ILLUSTRATION BY 731; REFERENCE PHOTO: ALAMY

"Some people don't even seem to know that it's BitTorrent. We send out copyright infringement notices, and they question why they received them."
—*Kyle Reed*

◀ In the U.S., Popcorn Time grew by 336 percent from July to January and now accounts for one-ninth of the country's torrent traffic, estimates Ceg Tek International, a company that movie studios contract to find and stop copyright infringement. Netflix declined to comment for this story.

Popcorn Time's crisp grids of TV shows and movies, including the most recent episodes and blockbusters, use art straight from marketing posters. The service looks so professional that many viewers think it's legal, says Kyle Reed, chief operating officer of Ceg Tek. "Some people don't even seem to know that it's BitTorrent," he says. "We send out copyright infringement notices, and they question why they received them. It just looks like Netflix to some people."

Creating a less cumbersome wrapper for BitTorrent was the primary objective of Popcorn Time's anonymous developers, a group of friends in Argentina, says a Dutch blogger who goes by Ernesto van der Sar and runs TorrentFreak, a news site that covers file sharing. The creators abandoned Popcorn Time just a few weeks after its launch, writing on their website that they needed to "move on with our lives." In an e-mail later revealed by the hack of **Sony**'s computer systems, the Motion Picture Association of America bragged at the time to Sony and other movie studios that it had "scored a major victory in shutting down the key developers of Popcorn Time" by coordinating with law enforcement on three continents. The MPAA declined to comment.

Nonetheless, Popcorn Time survived. Its code is open-source, so several other groups of coders quickly released versions after the site shut down. (Would-be viewers need to choose carefully; some of the knockoffs contain malware.) "We were users of the original and were sad to watch it go," wrote a developer of one of the spinoff versions, who answered an e-mail sent through his group's website and insisted on communicating through anonymous Internet chat software to protect his identity. "The amount of attention this project has been receiving is HUGE, ground breaking and way above anything we expected when we first picked it up."

The developers don't call themselves pirates. Asked about the consequences of making illicit file sharing easier, the anonymous developer claims Popcorn Time doesn't break any laws because it's just an index of other BitTorrent sites and doesn't host any pirated material. "The torrent world was here with millions of users way before us and will be here with BILLIONS of users way after us," he wrote.

Robert Red English, a developer of a separate Popcorn Time spinoff who communicated over Skype Instant Messenger from Ontario, also said the responsibility for obeying copyright laws should fall to users. "I'm not going to justify it," he wrote. "If it's stealing or not varies by country and each user is given the choice to use the program, and warned we use torrents. It's up to them to choose if they wish to continue."

That's a common defense among people who collect links to pirated videos, but judicial precedent doesn't back it up. The founders of Pirate Bay, a popular BitTorrent hub, made similar arguments in a Swedish court and received prison sentences. Older file-sharing networks such as Napster and Grokster shut down, because U.S. courts ruled that they were emboldening users to break laws. "If you are seen as encouraging people to infringe, then you have a copyright problem," says Corynne McSherry, the acting legal director of the Electronic Frontier Foundation, a nonprofit that advocates for consumer rights online. Users are also vulnerable to suits, she says, though most studios and other major rights holders no longer target individual viewers for redress.

Instead, the MPAA has for the past few months demanded that organizations such as EURid, the nonprofit that distributes .eu domain names, withdraw URLs from popular versions of Popcorn Time and that hosting company **LeaseWeb** withdraw the servers running them. The lobbying group has also sent takedown requests to sites such as **GitHub**, where programmers store the open-source code they're working on. GitHub declined to comment. The anonymous Popcorn Time developer says the added pressure is motivating him and his colleagues to finish a version of the software that operates entirely by connecting viewers' computers and doesn't rely at all on central servers. "When we release this, there will be nothing to be taken down again," he says.

Even if Popcorn Time's coders succeed in that effort, studios and

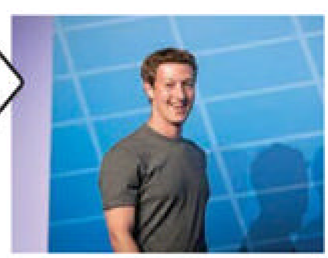
FROM LEFT: SIMON DAWSON/BLOOMBERG; ANDREW HARRER/BLOOMBERG; JODY AMIET/AFP/GETTY IMAGES; DAVID PAUL MORRIS/BLOOMBERG; MARK COOTE/BLOOMBERG; GIORGIO COSULICH/GETTY IMAGES

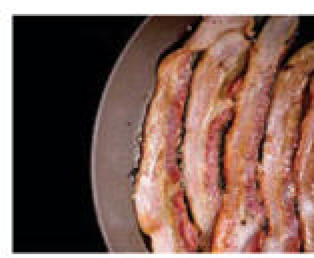
Software Elementary, My Dear Watson

For the past five years, IBM, Google, and a host of startups and universities have poured billions of dollars into developing artificial-intelligence software. Now it's report-card time. *Bloomberg Businessweek* asked computers loaded with some of the world's smartest AI software to identify the subjects in a series of photos. The results were conclusive: They're still learning. —*Jack Clark*

What they saw

What they called it





MetaMind	Cardigan	Churros
Clarifai	Portrait	Fat
Orbeus	Mark Zuckerberg	Roast
Watson	Person	No idea. Perhaps a "color"

The "human" filter for image-recognition startup Orbeus ID'd the Facebook founder. IBM's Watson described him as human.

legitimate streaming services will have at least one other way to answer its growing popularity: making sure legal alternatives are widely available, affordable, and desirable. In the U.S. and U.K., where Netflix and other legal streaming services are well established, Popcorn Time's Google search numbers are still way behind. —*Brad Stone*

The bottom line In a year, Popcorn Time has become the Internet's pirate service of choice, despite the MPAA's best efforts.

Hardware

Intel Buys Its Way Deeper Into China

- The company is spending billions on factories and state-owned rivals
- "You want to be in the good graces of the Chinese government"

Although **Intel** is the world's leading maker of chips for PCs and servers, the company has long struggled to land a significant piece of the mobile market, where **Qualcomm** dominates. Last year, Intel took in $55.9 billion in revenue, up 6 percent from the previous year; its mobile division accounted for $202 million. It may well be too late for Intel to catch up in the U.S. or Europe, where just about everyone who's going to buy a smartphone or tablet already has one with a rival chip inside. So instead of battling for the next iPhone contract, the company is pouring billions of dollars into expanding its influence in China, where fewer than half the country's roughly 500 million mobile phone users have smartphones.

Intel, which doesn't break out mobile earnings figures for China, has a long way to go before it's a serious force in the country's mobile market. Qualcomm chips are in most high-end phones, including those from Chinese leader **Xiaomi**, and Taiwanese company **MediaTek** controls the cheaper end of the market. At this point, the chip market in China is a duopoly, says Mark Hung, an analyst at researcher Gartner. Even if Intel reaches third place, "No. 3 is probably meaningless."

Nevertheless, Intel has in fits and starts tried to use its relationship with PC clients in China to nose its way into mobile devices over the past few years. The company supplies chips for Chinese-owned **Lenovo**, the No. 1 global PC seller, and its hardware powers a handful of Lenovo smartphones. Intel's partnership with Chinese Internet giant **Tencent**, which includes a joint research center, helps ensure that the WeChat maker's software works smoothly with Intel chips, says Rupal Shah Hollenbeck, Intel's general manager for China. "A lot of basic relationships have started in the area of software and services," she says.

Intel paid $1.5 billion in September for a 20 percent stake in state-run **Tsinghua Unigroup**, which controls two domestic mobile chipmakers. That may be double what Intel needed to pay, given that the leading Chinese chip company, **Semiconductor Manufacturing International**, has a

Where Intel's Chips Fall

FY13-14 revenue change

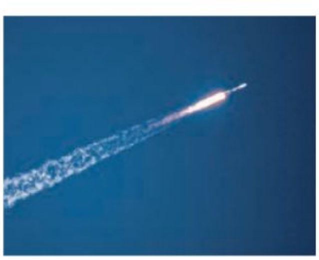
PCs	+4%
Data center group	+18%
Software and services	+1%
Internet of things	+19%
Mobile and communications	-85%
Other	+18%

Mobile made up less than one-third of 1 percent of 2014 revenue

DATA: BLOOMBERG

market valuation of about $3.2 billion. In December, Intel said it would pay $1.6 billion to upgrade its factory in the central Chinese city of Chengdu, which cost $300 million to build a decade ago. The plant, designed for back-end testing, will absorb some of the work previously done in a shuttered Costa Rican facility. Shah says it's part of a plan to shift more of Intel's resources toward China and to make more of its operations there as new and shiny as its $2.5 billion plant in Dalian, a port city in China's northeast.

The investments will help Intel work its way further into the local supply chain and better understand Chinese consumers, says Shah, a 20-year veteran of the sales and marketing division. Those relationships may become more significant as Intel's dominance of the PC market becomes less valuable, says Zennon Kapron, the founder of financial researcher Kapronasia in Shanghai. "Growth from partnering with expanding Chinese companies early on could ▶



Missile	Computer keyboard	Alp	Egyptian cat
Airplane	Technology	Landscape	Cat
Plane	Console	Nature	Cat
Airplane	An object	Scene	Cat

Only AI startup MetaMind understood that planes have to have wings.

The computers had trouble with one of their own. None could tell this was a laptop.

Every system correctly ID'd the cat. No doubt they've had plenty of practice.

certainly help Intel offset losses as the market for traditional PCs continues to soften," he says.

In the next battles for chip contracts, which will likely include many wearable-tech makers, a focus on emerging Chinese startups could give Intel a leg up, says Neil Wang, an analyst and partner at market-research firm Frost & Sullivan. "Neither Intel nor Qualcomm has any advantages in this new wave," he says.

Intel may be more favorably treated by Chinese regulators because of its stake in Tsinghua Unigroup—as well as its willingness to build high-end local labs. So far, Intel hasn't been touched in China's crackdown on foreign companies. Qualcomm spent more than a year negotiating with antitrust authorities before agreeing to pay $975 million to settle allegations that it used its control of the chip market to charge inflated licensing fees. During that time, the company cut its earnings forecast as Chinese customers held off paying its fees. "Although Qualcomm is disappointed with the results of the investigation, it is pleased that the [government] has reviewed and approved the company's rectification plan," Qualcomm said in a Feb. 9 statement announcing its settlement. The government has also investigated **Microsoft** for alleged antitrust violations and antivirus maker **Symantec** for allegedly building spying capabilities into its software.

"You want to be in the good graces of the Chinese government," says Gartner's Hung, who calls Intel's Unigroup investment "good business sense." Kapron says Microsoft had to build research labs in China and work with universities before the government began making sure it got paid for some of the copies of Office programs circulating throughout the country.

Intel will also need to keep spending, Kapron says. Intel head Shah says she uses much of her energy identifying promising local startups she can spur along with some funding from the company's investment arm, Intel Capital. "If we don't start relationships with them now, we will get behind," she says. "Until less is more, more is more." —*Christina Larson*

The bottom line Intel is spending billions in China in an effort to catch up with dominant mobile chipmaker Qualcomm.

Startups

The Tech Tastemaker You Can Game

▶ User-ranked listings site Product Hunt attracts venture capitalists

▶ "Not everybody is trying to change the world"

They came by the hundreds, spilling out of Ubers and Lyfts to wait in line in front of Jones, a bar in San Francisco's Tenderloin district. The draw that January night was **Ryan Hoover**. The occasion: the one-year anniversary of his company, **Product Hunt**, an online publisher-aggregator that's become the hot arbiter of tech products.

Every weekday, Hoover, his staff, and a team of volunteer curators single out about 50 recently introduced tech items—mobile apps, gadgets, software, hardware—for mention on Product Hunt's listings site and in a daily e-mail newsletter. Users who register with the site can vote on listings, helping to push them up on the homepage. About 8,000 people have been granted access to comment—a self-selecting group, where existing commenters invite others to join in.

Product Hunt has become the place for those in the tech world to learn about new products. Investors follow it for ideas about where to put their money; entrepreneurs and developers check on what the competition is up to; and writers and editors use it for story ideas. Startup founders often go to the site to defend their products against criticism or to talk them up. Product Hunt's listings offer a way to control the message about a product because entrepreneurs can respond to questions and critiques.

Groupon co-founder Andrew Mason and former Facebook executive Bret Taylor used Product Hunt when launching new companies last year because the executives could get immediate feedback from early adopters. Hip-hop artist Nas and New York Knicks forward Carmelo Anthony, both investors in tech startups, are regular readers. "I haven't seen anything that captures the magic of the times we live in the way Product Hunt does," says Mason, whose new company, the travel guide service **Detour**, scored a mention on the site last year.

The list is a microcosm of the startup world. Product Hunt has recently flagged messaging services **Taptalk** and **Yo**, link-sharing app **Point**, credit card protection service **Final**, and productivity software company **Workflow**. Product Hunt hasn't released stats on its number of active users but says it has more than 100,000 registered members.

Quoted

"We cannot always immediately implement the most innovative methods to detect and prevent fraud without considering other factors."

TurboTax maker **Intuit** in a Feb. 23 statement denying reports that it knowingly processed phony tax returns to collect the fees

HOOVER: DAVID PAUL MORRIS/BLOOMBERG; PLAYBOOK: COURTESY BLACKBERRY; XPERIA: COURTESY SONY; FIREFOX: COURTESY MOZILLA

Hoover, 28, is one of the most visible beneficiaries of San Francisco's startup boom. Over the past four months, he's raised more than $6 million from venture capitalists, including **Andreessen Horowitz**. He's used the money to hire five employees and to move his operations from a Philz Coffee shop into an $8,000-a-month space in downtown San Francisco. Hoover's planning Product Hunt offshoots, including websites to curate video games and music. (Bloomberg LP, which owns *Bloomberg Businessweek*, is an investor in Andreessen Horowitz.)

One of Hoover's favorite apps is called **Mindie**, which makes 10-second music videos that can be shared. Another, **Drake Shake**, superimposes a picture of the hip-hop artist Drake onto selfies. "People shouldn't be so damn judgmental about people creating things—a silly app is just something fun," he says. "Not everybody is trying to change the world, and part of my frustration is people start complaining that we are spending our time wasting it on things that don't matter when not everything is supposed to matter."

After graduating from the University of Oregon in 2009, Hoover moved to San Francisco to find a job in the tech industry. He worked at PlayHaven, a video game company, for about three years, then quit because he was bored, he says. He started to blog about entrepreneurs and startups and sent e-mails seeking meetings with investors and tech company executives such as angel investor Paul Graham and Kevin Rose, the co-founder of news aggregator Digg.

Hoover wakes up at 5:30 a.m. every day to scour the Web for worthy items, and he's constantly texting, e-mailing, blogging, podcasting, or posting comments on Product Hunt. Featured startups sometimes receive a handwritten note from him.

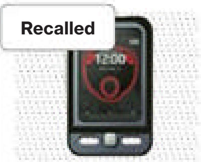
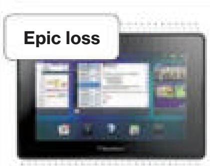
At the anniversary party, many guests were aspiring Hoovers, obsessing over their own startups. Some asked him to pose for pictures. "I have to be hyper-aware about what I do and what I say," Hoover says. —*Adam Satariano and Eric Newcomer*

The bottom line Product Hunt, backed by more than $6 million in funding, generates instant buzz around the tech products it picks.

~~Innovation~~ Duds

Immobile Communications

Mobile World Congress, the wireless industry's biggest annual conference, will be held from March 2 to 5 in Barcelona. Over the last two decades it's been a coming-out party for Nokia's once-mighty mobile phones and Samsung's Galaxy line. Here's a look at some hyped products from past shows that didn't quite work out. —*Cornelius Rahn*

	The hype	The hard truth
Recalled 	**Neonode N2**, Neonode, 2007 Three years after the Swedish company became one of the first to make a touchscreen phone, it tried to go head-to-head with the iPhone, which it said "follows the lead set by Neonode."	The first shipments of N2 phones were recalled a few months after release because of what Neonode described as "reception problems." The company shut down its mobile phone business and now licenses its touchscreen technology.
Fail 	**E-ink Readius**, Polymer Vision, 2008 Developed by a Philips spinoff, this foldable e-reader fit in a suit pocket.	Turns out people don't mind lugging big slabs such as the iPad for reading. Despite a distribution deal with Telecom Italia, the Readius didn't sell, and Polymer went out of business in 2012.
Not cool 	**Windows Phone 7**, Microsoft, 2010 Microsoft said its new mobile operating system could beat iOS and Android. It came with a sleek interface integrated with social networks, its Zune music player, and Xbox games.	Only Nokia fully committed to the Windows Phone OS, and Microsoft had to buy Nokia's phone business to stay in the market. In 2010, Windows Phone ran on about 8 percent of smartphones; today, it's at 3 percent, according to Gartner.
Epic loss 	**PlayBook**, Research In Motion, 2011 Seeing its fortunes on the wane, BlackBerry maker RIM launched its iPad challenger: a long-promised tablet with superior computing power and two cameras.	The PlayBook lacked an e-mail app, and its battery was feeble. After dismal reviews and sales, RIM (now called BlackBerry) wrote down more than $1 billion in unsold inventory and gave up on tablets.
Just bad 	**Xperia play**, Sony Ericsson, 2011 Teased in a Super Bowl ad, the combo PlayStation and smartphone was meant to bridge the gap between Angry Birds and Grand Theft Auto with its slide-out control pad.	For the price of the Xperia play, consumers could buy an Android phone and a separate gaming handheld. People balked at paying $10 a game when smartphone games often cost $1 or less.
Maybe? 	**Firefox OS**, Mozilla, 2013 Mozilla promised $25 smartphones that wouldn't be beholden to Apple, Google, or Microsoft.	Partly because Android phones are getting cheaper, the Firefox OS has less than 1 percent of the market and is sold mostly in developing countries.

Edited by Jeff Muskus
Bloomberg.com

PHOTO ILLUSTRATION BY 731; PHOTOS: GETTY IMAGES (2)

▶ **Would you like a little lettuce with that colonial? Developers use farms to lure homebuyers**

▶ **"A farm is about 20 percent of the cost of a golf course"**

American builders have a long history of bulldozing farms to make way for housing developments. Now developers are starting farms to sell homes. Harvest, a $1 billion "urban agrarian" community being built by H. Ross Perot Jr.'s **Hillwood Development** in Texas, hired a farmer to cultivate vegetables before construction began on a planned 3,200 houses. Willowsford, a community of 2,130 homes in Virginia's Loudoun County, set aside 2,000 acres of green space, including 300 acres for raising fruit, vegetables, chickens, and goats. Developer **DMB** integrated produce fields and edible gardens into projects in Arizona, California, and Hawaii.

As the housing industry recovers, developers are counting on fresh veggies to tempt retired baby boomers looking to eat local and parents intent on nurturing children on organic meals. "The foodie generation has come of age," says Ed McMahon, a resident fellow at the Urban Land Institute in Washington. "The mainstream development community has come to think of these as a pretty good way to build a low-cost amenity that people seem to like and that also adds authenticity."

Agrihoods, as they're known, such as the 359-home Prairie Crossing outside Chicago, began cropping up in the 1980s. What's changed is the size and number of projects and the entry of large corporate developers. A restored 19th century farmhouse and 5-acre commercial farm sets Harvest apart from other subdivisions northwest of Dallas, according to Tom Woliver, Hillwood's director for planning and development. "You need to attract some interest," he says. "Food brings everyone together."

At the Willowsford development in Virginia, Susan Mitchell says the outdoor stand selling community farm berries, asparagus, and carrots is a gathering place for neighbors. Mitchell, who bought a four-bedroom **Hovnanian Enterprises** house with her husband, can walk to the stand with her young sons, stopping along the way to pick flowers, pet goats, and chat with the resident farmer. "It's having a little more nature in your backyard than the normal community," she says.

Willowsford's farm, which runs at a deficit for now, will break even by about 2018 as more residents, local restaurants, and markets purchase its food, according to Brian Cullen, head of Willowsford's development team. Cullen

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Charlie Rose talks to BlackRock's Larry Fink 39
Bid/Ask: Volkswagen scraps a 270 mph loser 41

says companies that built communities around golf courses spent a lot more and found only a few residents played. "A farm is about 20 percent of the cost of a golf course," he says.

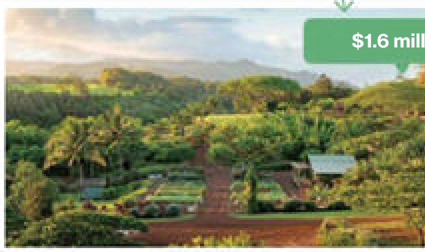
About 500 of the planned 2,130 homes have sold since Willowsford opened in 2011. Prices currently start at about $600,000. Two community centers have demonstration kitchens for pop-up restaurants, wine tastings, and culinary classes. "We're very focused on having the economics of it work and having a real farm experience," Cullen says. Willowsford is the best selling of Hovnanian's 20 communities in Northern Virginia, according to its group president, Peter Thompson. "Everybody's fighting for sales," he says. "The farm component is a real and very positive influencer."

New Home Co. broke ground in January on a barn that will be the centerpiece at the Cannery, a 547-residence community in Davis, Calif., with a 7.5-acre farm and a full-time farmer. Almond and pear trees will line bike- and footpaths linking the Cannery to the nearby University of California at Davis, a top U.S. agriculture school. Residents will be encouraged to sign up for delivery of fruit and vegetables grown on-site, while other produce will be sold to markets and restaurants. "It's not just a gimmick that will go away when the sales office closes," says Kevin Carson, New Home's Northern California division president.

At DMB's Kukui'ula, a 1,500-unit resort on the Hawaiian island of Kauai, gardens offer vacation-home owners a chance to get their hands dirty while picking fresh decorative flowers and tropical produce that's also used at local restaurants. Bungalows start at $1.6 million in the oceanside community, which also features a spa, a fitness center, swimming pools, and a Tom Weiskopf-designed golf course. "We spent a fraction of our amenities budget on the farm, but it was clear to us very early on that we had hit a nerve," says Brent Herrington, DMB's executive vice president.

Boosting home sales isn't the only reason developers are weaving farms into their subdivisions. Tony Moiso, chief executive officer of **Rancho Mission Viejo**, says he wants to

Starting prices for homes



Kukui'ula in Hawaii

Willowsford in Virginia

Harvest in Texas

Rancho Mission Viejo in California

FROM TOP: COURTESY KUKUI'ULA; COURTESY WILLOWSFORD; COURTESY HARVEST; COURTESY RANCHO MISSION VIEJO

preserve green space in perpetuity at his project in southern Orange County, Calif. The community farms and vegetable gardens give residents of the 14,000 planned homes educational tools to learn respect for the land, he says. About 17,000 of Rancho's 23,000 acres will be preserved as lemon and avocado groves, cattle ranges, and forests.

Rancho Mission Viejo hired full-time farmers to promote community involvement in cultivation and ensure the fields flourish even if residents lose interest. "This helps us sell, but it's a bigger story for us," says Moiso, whose family has owned the land since 1882. "It has to do with the culture of care, about the blessings of the land, and the idea that food doesn't just show up at places like Trader Joe's." —*John Gittelsohn*

The bottom line Working farms and vegetable gardens are replacing golf courses and granite countertops as bait for new homebuyers.

Activists

Dan Loeb Battles The Yellow Robots

▶ The hedge fund billionaire wants Fanuc to make better use of its cash

▶ "It's the 21st century.... They should communicate with their investors"

Fanuc, the ultraprofitable Japanese robotics company, has spent decades building a wall of secrecy around its business. Outsiders are rarely allowed into its manufacturing complex on the slopes of Mt. Fuji, where an army of yellow robots works 24/7 making more robots in windowless yellow factories. For security reasons, e-mail is mostly banned; business is often done by fax. There's no investor relations department and no conference calls with analysts. The founding Inaba family has the company under a tight grip, even though it owns little of the stock.

Now Daniel Loeb wants to crack the company open. The activist investor and founder of hedge fund **Third Point** disclosed in a letter to his shareholders that he'd bought a stake in Fanuc, which has a market value of $46 billion, and is agitating for change. "This company is so incredibly innovative and forward-looking in terms of its operational culture," Loeb says. "From a capital allocation standpoint, not so much."

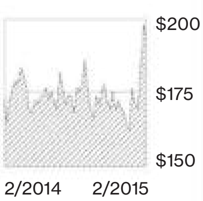
With an operating profit margin topping 40 percent, Fanuc makes 25 percent more income per employee than Goldman Sachs, according to Loeb. Still, he says, the company would be worth "significantly" more if it bought its own shares back, using some of the $8.5 billion in cash on ▶

its balance sheet. Investors have been making similar complaints for years. Fanuc spokesman Keisuke Fujii declined to comment.

There isn't much history of investor activism in Japan, and foreigners who've tried it have returned humbled. T. Boone Pickens, who helped pioneer the hostile takeover in the 1980s, gave up on Japan in 1991 after losing a battle to gain a board seat at a supplier to Toyota Motor. In 2007, Warren Lichtenstein, founder of Steel Partners, said he planned to "educate" Japan's managers. He ultimately abandoned his takeover bid for beermaker Sapporo Holdings. "What's the track record of activist investors in Japan? Not good," says Alberto Moel, an analyst at Sanford C. Bernstein in Hong Kong. "And Fanuc is probably one of the worst ones you can try."

Asked why he thinks he can succeed where others have failed, Loeb hesitates, checks with his public-relations adviser, who's listening, and says: "I don't know. It was long standing that it was illegal for people of the same sex to marry in New York, but we took on that issue and we affected some change." As for Fanuc, "I don't think that just because something has been wrong for a long time that it should be wrong forever."

Fanuc's stock price



In the U.S., Loeb made his name and fortune shaming corporate executives into quitting or changing tack. In one of the public letters that built his reputation, he called the board of Salton, the company that makes George Foreman grills, "pathetically weak individuals" who were "in over their heads." It's not an approach Loeb plans to try in Japan. "There's a right way and a wrong way in engaging with company management in Japan," he says. "The wrong way is the way some people have done it in the past, which is in a confrontational, disrespectful way."

In May 2013, Loeb took on **Sony**, proposing that it spin off part of its entertainment business and requesting a seat on its board. He got neither, though he did manage to cajole the movie studio into cutting costs, and sold his stake at a profit, he says.

Putting pressure on Fanuc could prove more difficult. The robot maker has no outside board members. President Yoshiharu Inaba has rarely met investors and doesn't give briefings in Tokyo as most other major Japanese company heads do. Those who want information must trek to Fanuc's remote campus in Oshino Mura (pop. 8,656), two hours west of the capital, where he takes questions twice a year—always wearing a yellow blazer. Founder Seiuemon Inaba favored yellow, according to company lore, because it promoted clear thinking.

David Herro, manager of the $28.6 billion **Oakmark International Fund**, says that from 2012 to 2014 he owned about 0.5 percent of the company, a stake valued at $100 million. He says he was rebuffed when he tried through back channels to question Fanuc's inefficient use of cash. The best he could do was to get a meeting with one of Fanuc's accountants—"some low-level guy," he says—on the sidelines of a tool show in Chicago. "Yes, we made an effort to talk to the top people and, no, we did not succeed," Herro says. "It's a very good business, but they run that thing like it's a family farm."

Fanuc's computerized controls, used in more than half of the world's machine tools, give lathes, grinders, and milling machines the agility to turn metal into just about any manufactured product, from a titanium hip implant to the aluminum strut in the wing of a Boeing 747. Fanuc's Robodrill, an all-in-one machining center, is used to shape the shiny metal band that wraps around the iPhone. "They've got great clients like Apple," Loeb says. "And with labor costs going up," the automation industry "is an obvious area of growth."

Morten Paulsen, head of Japan research at CLSA Asia-Pacific Markets, says there have been small signs of change since late 2013, when Seiuemon Inaba stepped down, leaving his son, Yoshiharu, in control. Seiuemon's grandson, Kiyonori, a 37-year-old with a Ph.D. in mechanical engineering from the University of California at Berkeley, became a board member at the same time. "This company is less of a one-man show than what it was," Paulsen says.

When Loeb took on Sony, he flew to Tokyo, where he was able to hand-deliver his demands to Chief Executive Officer Kazuo Hirai. With Fanuc, Loeb doubts he'll even get in the door. "I'm not used to companies not meeting with their shareholders, but it's been a long-standing policy of theirs," he says. "It's the 21st century. If they want to be a public company, they should communicate with their investors."

Loeb's move on Fanuc could be profitable whether or not he succeeds. The company's stock has jumped more than 10 percent since Loeb's letter. "It's plausible that it's a self-fulfilling prophecy, where Loeb makes some noise and the stock goes up," says Amir Anvarzadeh, manager of Japanese equity sales at BGC Partners in Singapore. "But Fanuc will probably triple over 10 years, with or without him." —*Jason Clenfield, with Dave McCombs*

The bottom line Activist investor Dan Loeb wants Fanuc to put its $8.5 billion cash hoard to work to help boost returns to shareholders.

Mutual Funds

Stockpickers Say They'll Be Back

- They can't show their stuff in a steadily rising market
- "There won't be any active managers left"

Robert D'Alelio has the kind of long-term record every mutual fund manager aspires to. His $12.6 billion **Neuberger Berman Genesis Fund** has outperformed 98 percent of small-company funds over the past 15 years and crushed its benchmark, the Russell 2000 index. D'Alelio's results for the past five years, when his fund slumped, aren't so enviable. He's got company: Other stockpickers with outstanding long-term records, including Donald Yacktman at the **AMG Yacktman Fund** and the team of O. Mason Hawkins and G. Staley Cates at the **Longleaf Partners Fund**, trailed their benchmarks in the same period after excelling in the previous 10 years.

The managers say they haven't changed, the market has. The Federal Reserve's policy of keeping ▶ 40

COURTESY FANUC

Charlie Rose talks to...

Larry Fink

The chief executive officer of BlackRock discusses the economic impact of Greece, cheap oil, and D.C. gridlock

LAM YIK FEI/BLOOMBERG

Your company manages $4.6 trillion in assets, more than anyone. How did that come about?
I surrounded myself with really smart men and women. We had a really simple business model. We remain what we were 27 years ago. We're only an asset management company. All our business is on behalf of our clients. All our revenues are from our clients. We don't have our own accounts. When we started the company, 25 percent of the founders had a technology and risk-management background, and we've been able to consistently build this platform. We believe in globalization, and we're in 41 different countries where we have over a billion dollars of assets on behalf of our clients.

What's your economic forecast for 2015?
The world's improving. The U.S. economy is going to grow a little faster than last year, though probably a little weaker in the first quarter. Europe's going to be incrementally better, because they've fixed their banking crisis. They've benefited from a very weakened euro. And then you have economies like India, which was stagnating at around 5-ish percent GDP growth a year ago, and now they're going to receive the benefit of lower oil prices. That's going to add at least 1 percent to India's GDP. Prime Minister Narendra Modi's reforms will probably add 1 or 2 percent more growth to overcome all the weakness in China.

What do you expect to happen with oil prices?
The change in the oil market is driven by technology. We spend too little time focusing on how technology is changing our everyday economy, but I look at this as transformational. It's going to create a permanent reduction in the cost of petroleum products. Can oil go back from where it is, around $50, to $70 or $80? Sure. But I don't think you're going to see it back at $100. Unlike all the other oil shocks we've witnessed in our lifetimes, which were demand-driven, this was supply-driven, and the supply was created by new technology.

Is the Keystone XL pipeline necessary?
Certainly not. It's a symbol today. I was not against Keystone when it was originally proposed. But the fact that we did not do the pipeline [made us] more active in North Dakota in producing oil. We actually became more self-reliant because we did not do Keystone. I didn't understand why we vetoed it originally. My strong view is that North America is the best place to be in the world today, and I'm talking Mexico, Canada, and the U.S. The fact that we cannot create a cooperative regional energy system is a shame.

Are you alarmed by the dysfunction in Washington?
It's not alarming to me anymore, because I'm numbed. I think our economy would be growing at 4 percent today if we had a more productive Washington. We don't have an infrastructure policy. I'm focusing on infrastructure investing in India, in Mexico. I can't focus in the U.S., because it's so hard to get anything done.

"Our economy would be growing at 4 percent today if we had a more productive Washington"

Talk to me about the situation in Greece and its impact.
A lot of people are asking, "Why are the markets calm about Greece?" But Greece is no longer a private-sector problem. In 2010 the private sector owned most of its debt. Today, 70-ish percent of that debt is held by the [European Central Bank], Greek banks, and then there's the IMF, which has a huge loan outstanding to Greece. If you think about what's transpired in the last five years, we've had a transformation.

How do you see that shift? What does it change for the Greeks?
Greece, in my mind, is part of the international grid. If you want to remain in the grid, you're going to have to ultimately conform. If they don't conform, they're going to become Argentina; they did things the global economies said were wrong, and now they have no access to capital from outside. If Greece walked away today, its banks would be bankrupt. Greece experienced a 26 percent decline in GDP from 2008 to now. If they walked away, I think they would fall another ungodly amount.

Watch Charlie Rose on Bloomberg TV Weeknights at 7 p.m. and 10 p.m. ET

interest rates near zero has artificially inflated prices of lower-quality U.S. stocks, they say, punishing investors who focus on businesses with the best fundamentals. At the same time, the steady strength of stocks of all stripes has left managers with few chances to sniff out bargains or show what they can do under more volatile conditions. "In straight-up markets you don't need active managers," D'Alelio says. "If the next five years are the same, there won't be any active managers left."

$98b

Total redemptions from actively run U.S. stock funds in 2014

Only 20 percent of nonindex mutual funds that invest in U.S. stocks beat their target indexes in 2014, and just 21 percent topped the indexes in the five years ended Dec. 31, according to data from Morningstar. Over 10 and 15 years, the winners rise to 34 percent and 58 percent, respectively.

Investors have expressed their displeasure with active managers by moving money to low-cost funds that mimic indexes. In 2014 actively run U.S. stock funds suffered $98 billion in redemptions, while index funds took in $167 billion. Passive managers have 38 percent of the $8.7 trillion stock fund business, more than twice their share 10 years earlier, Morningstar data show.

The Yacktman Fund has averaged an annual return of more than 13 percent for the past 15 years, handily beating the Standard & Poor's 500-stock index. Over the past five years, the fund trailed the index. The lack of market corrections has hurt. "A lot of our outperformance comes in difficult environments," says Jason Subotky, a co-manager of the fund.

The $4.9 billion **Royce Premier Fund** beat 97 percent of similar funds over 15 years, a number that drops to 7 percent over five years, Morningstar data show. "We have been using the same process to pick stocks for 40 years, and we have confidence in it," says Frank Gannon, co-chief investment officer. The Fed's keeping interest rates near zero for the past six years has had the "unintended consequence," he says, of taking the pressure off companies with heavy debt loads and weak earnings, so low-quality stocks have done as well as or better than financially sound ones.

Jeff Tjornehoj, an analyst with fund tracker Lipper, doesn't buy the idea that certain types of markets are tougher on stockpickers. "It sounds like a team complaining about the rain, when everyone has to play under the same weather," he says.

The current market is reminiscent of the late 1990s, say Hawkins and Cates, who have overseen the $7.5 billion Longleaf Partners Fund for more than two decades and still have one of the best 15-year records. Back then, as now, stocks marched higher "while fundamentals mattered little," the pair told shareholders in a January letter. Once the dot-com bubble burst in 2000, stockpickers eventually regained favor. "At this moment of relative weak performance with active management in disrepute, our optimism about future relative performance is exceptionally high," they wrote. Neuberger's D'Alelio agrees that the pendulum will swing back. "This is setting up as an ideal environment for stockpickers," he says. —*Charles Stein*

The bottom line Only 20 percent of nonindex mutual funds investing in U.S. stocks beat their benchmarks in 2014.

Investing

Lady Braga Steps Out From Behind the Curtain

▶ In her first solo month, a hedge fund star sees a 9.5 percent gain

▶ Computers take "the emotion out of trading.... A black box doesn't care"

Leda Braga stood on a stage at Geneva's InterContinental hotel in February and sang Pharrell Williams's *Happy*. "Can't nothing bring me down, my level's too high," she shouted to about 80 employees of **Systematica Investments**, her new hedge fund firm, her voice hoarse after a day of meetings. "Nobody wanted to sing in the beginning," says Braga, called Lady Braga by some colleagues. "I believe in leading from the front, so despite my lack of talent, I did sing."

Braga, a 48-year-old Brazilian with a doctorate in engineering, had reason to be upbeat. After 14 years at Michael Platt's **BlueCrest Capital Management**, she struck out on her own on Jan. 1, taking with her the two main BlueCrest funds she oversaw. In the first month of trading after the split, her biggest fund, BlueTrend, returned 9.5 percent, one of the biggest gains for any hedge fund in January.

Now she's managing more money than any other woman in sole charge of a hedge fund. Along with BlueTrend, which has assets of $8.4 billion and trades futures in equity, bond, foreign exchange, and commodity markets around the globe, Braga runs BlueMatrix, a $600 million fund that trades equities.

Braga says she and Platt had considered the split "on and off" for some time, and parted amicably. "Leda is a great friend of mine, and we are still equity holders in her business," Platt said in an e-mail. The move came after BlueCrest was criticized by a hedge fund advisory firm for not providing enough information about a fund open only to BlueCrest employees. Chief Financial Officer Andrew Dodd said last year that BlueCrest has made "adequate" disclosures to investors about the fund.

Braga's BlueTrend and BlueMatrix are so-called systematic funds that rely on computer algorithms to make trades. "Systematic trading takes the emotion out of trading," says Braga at her office in Geneva, overlooking the Swiss Alps. When a trader is forced to sell at a loss, "he takes that home with him," she says. "A black box doesn't care."

Systematic investors program their computers to exploit correlations

Many Happy Returns

BlueTrend's annualized gain since it began trading in 2004

11.8%

PHOTO ILLUSTRATION BY 731; PHOTOS: BRAGA: COURTESY SYSTEMATICA; HAT: KEVIN MAZUR/WIREIMAGE/GETTY IMAGES

between stock and bond performance and other data, such as interest rates, economic growth, or even weather. “There’s a creative moment when you think of a hypothesis, maybe it’s that interest rate data drives” currency rates, she says. “So we think about that first before mining the data. We don’t mine the data to come up with ideas.”

Born and raised in Rio de Janeiro, Braga moved to London in 1987 to attend Imperial College, where she earned her doctorate. She spent about seven years as an analyst on the derivatives research team at JPMorgan Chase. There, she met Platt, who was on the bank’s proprietary-trading desk and left to start BlueCrest in 2000. Braga joined him the following year, managing $300 million for the BlueCrest Capital International fund. As her systematic strategy became more successful, she was given her own fund, BlueTrend, in 2004. It wasn’t until 2008, when her fund returned 43 percent during the worst year ever for hedge funds, that money began pouring in. BlueTrend’s annualized rate of return since it began trading on March 31, 2004, is 11.8 percent, compared with an 8 percent annualized return for the Standard & Poor’s 500-stock index.

Since Systematica separated from BlueCrest, its assets have grown to $9.2 billion from $8.5 billion. Braga says she’s planning to expand by creating new products, such as a fund that uses algorithms to trade over-the-counter derivatives and one that charges only management fees and doesn’t take a share of investing profits. Her standard fee is 1.5 percent of assets, plus 20 percent of profits.

BlueTrend’s assets have slumped from a peak of $15.4 billion in April 2013, when investors began pulling money after two mostly flat years. The fund declined 11.5 percent in 2013, then gained almost 13 percent last year. “Systematic models, like every other investment model, don’t work all the time,” says Ewan Kirk, chief investment officer of hedge fund Cantab Capital Partners and a friend of Braga’s. “We tend not to intervene with the car itself,” says Braga, who until recently rode a Ducati Monster 700 motorcycle. “But the engine gets fine-tuned.” —*Lindsay Fortado*

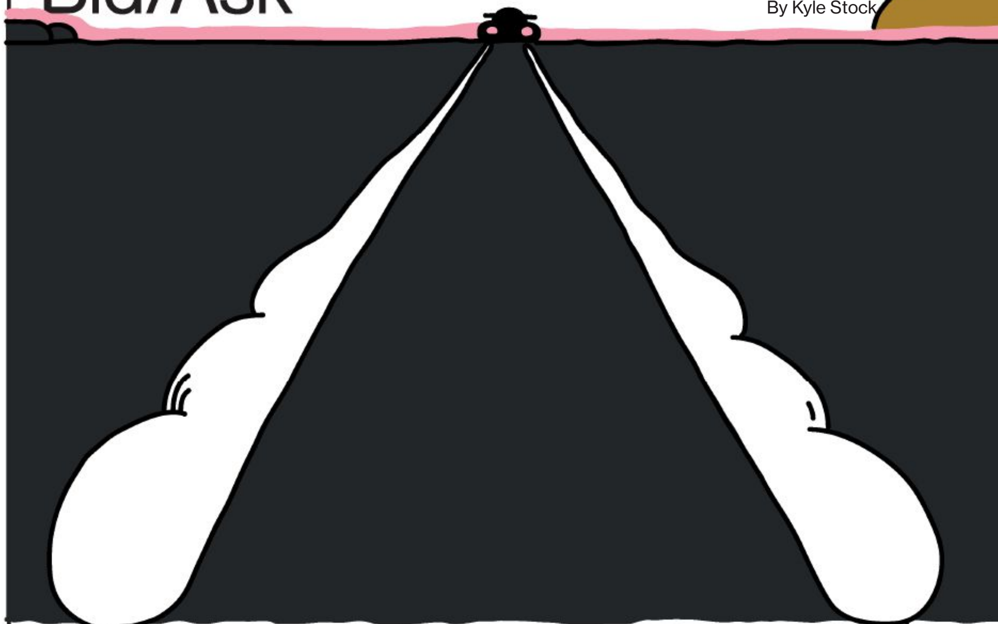
The bottom line Braga manages more money—about $9 billion—than any other woman running a hedge fund.

Edited by Eric Gelman
Bloomberg.com

ILLUSTRATIONS BY OSCAR BOLTON GREEN

Bid/Ask

By Kyle Stock



$2.6m

Volkswagen’s Bugatti sold the last of its Veyron supercars. In 10 years of production, the France-based company made only 450 of the vehicles, the fastest of which could reach speeds of almost 270 miles per hour. Despite the high price tag, Volkswagen lost an estimated $5.2 million on each Veyron, because they were so expensive to design and produce.

$10.4b **Valeant will buy Salix.** The maker of gastrointestinal drugs, including the antibiotic Xifaxan, is the latest in a series of acquisitions for the Canadian pharmaceutical giant.

$3.5b **British American Tobacco rolls up Souza Cruz.** The company is purchasing the 25 percent of its Brazilian unit that it doesn’t already own.

$3.2b **Asahi Kasei buys a battery giant.** Polypore International specializes in the dry-process batteries used by Tesla Motors and some of the world’s largest carmakers.

$1.4b **Silvio Berlusconi bids on state TV towers.** The proposal would make the former Italian prime minister’s Elettronica Industriale the country’s largest broadcast-tower operator.

$1b **Boeing offloads overweight 787s.** Purchasers got discounts on 10 of the planes from early in the production cycle because they are heavier than promised.

$915m **Hitachi acquires a train business.** The deal includes two railroad equipment units of Finmeccanica, which has been shifting its focus to military products.

$624m **Keurig Green Mountain buys back stock.** The single-serving-coffee specialist will acquire 5.2 million shares held by Italian coffee company Luigi Lavazza.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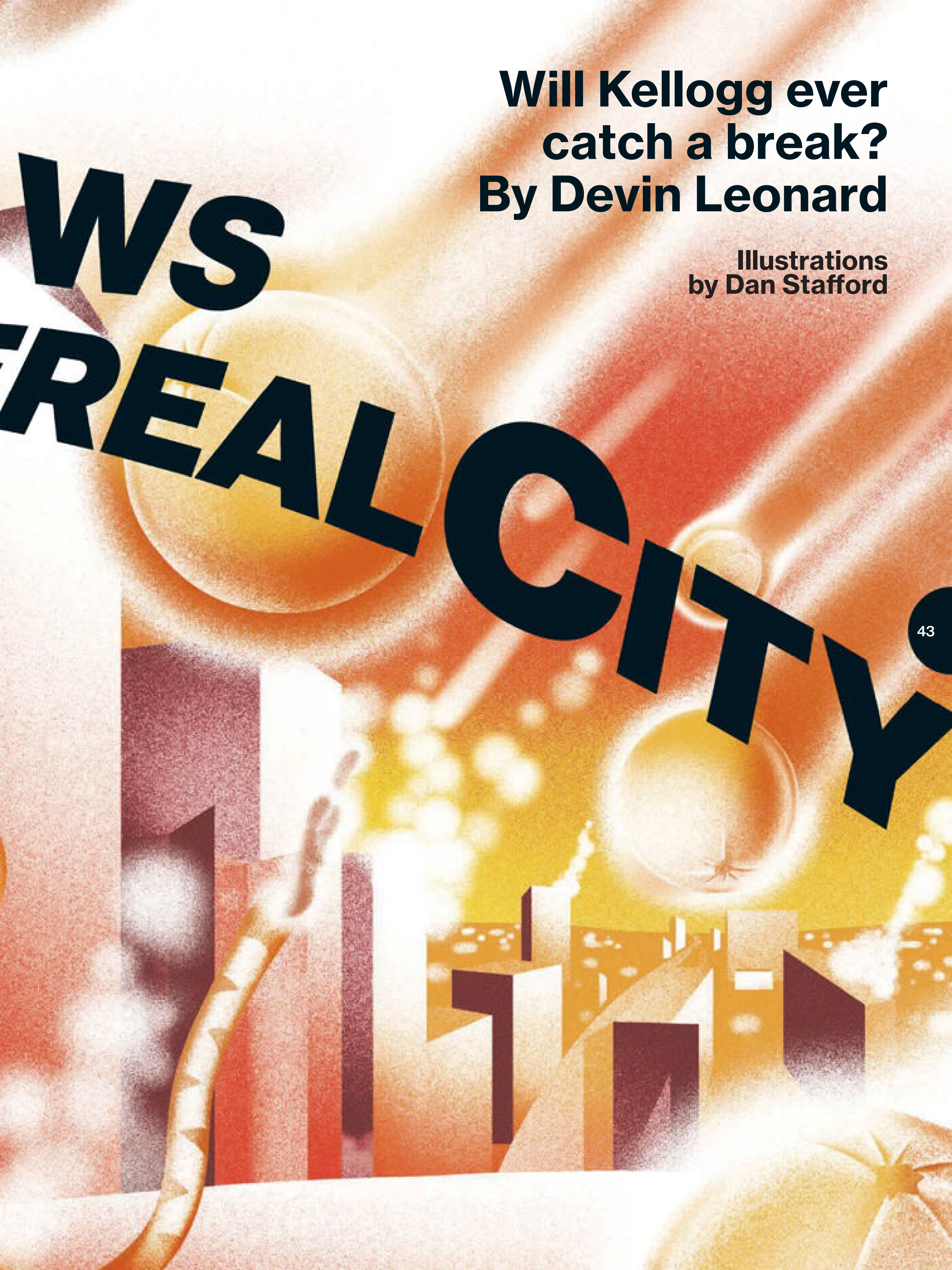


WS EREAL CITY

Will Kellogg ever catch a break? By Devin Leonard

Illustrations by Dan Stafford

John Bryant is a voracious cereal eater. Most mornings, he has a bowl of Kellogg's All-Bran Buds, a spinoff of the company's 99-year-old All-Bran, originally marketed as a "natural laxative." At night he's likely to snack on Honey Smacks, which is 56 percent sugar by weight. Sometimes he'll mix it with more nutritious Frosted Mini-Wheats. Bryant also feeds the stuff to his six children. "I can assure you that we go through an enormous amount of cereal," he says.

This makes the Bryant household somewhat of an anachronism at a time when Americans have moved on to granola bars, rediscovered the virtues of hot meals such as oatmeal and eggs, and fallen under the spell of Greek yogurt. But then Bryant would probably feel guilty if he joined them. He's chief executive officer of Kellogg, the world's largest cereal maker, whose brands also include Frosted Flakes, Rice Krispies, Corn Flakes, Froot Loops, and Apple Jacks. Kellogg needs all the cereal eaters it can muster.

On Feb. 12, Bryant, fortified by his customary helping of All-Bran, arrived at Kellogg headquarters in Battle Creek, Mich., to deliver bad news. He announced the company's U.S. morning-foods net sales fell 8 percent in the fourth quarter of 2014. It was the division's seventh quarterly decline in a row. "It's very frustrating," Bryant said in a postmortem telephone interview.

For almost a century, Kellogg defined the American breakfast: a moment when people would be jolted out of their drowsiness—often with a stupendous serving of sugar. Breakfast was personified by Kellogg's cartoon mascots like Frosted Flakes' vigorous Tony the Tiger; Froot Loops' pig Latin-spouting Toucan Sam; and Rice Krispies' Snap, Crackle, and Pop, a trio of elves who mischievously splashed around in a milky bowl.

Kellogg still spends more than $1 billion a year on advertising, but it no longer has the same hold on breakfast. The sales of 19 of Kellogg's top 25 cereals eroded last year, according to Consumer Edge Research, a Stamford (Conn.) firm that tracks the food industry. Sales of Frosted Flakes, the company's No. 1 brand, fell 4.5 percent. Frosted Mini-Wheats declined by 5 percent. Meanwhile, Special K Red Berries, one of the company's breakout successes in the past decade, fell by 14 percent. Kellogg executives don't expect cereal sales to return to growth this year, though they hope to slow the rate of decline and do better in 2016. But some Wall Street analysts say cereal sales may never fully recover. In Battle Creek, so-called Cereal City, that would be the equivalent of the apocalypse.

The 49-year-old Bryant, who resembles a cereal box character himself with his wide eyes, toothy smile, and elongated chin, blames Kellogg's financial woes on the changing tastes of fickle breakfast eaters. The company flourished in the Baby Boom era, when fathers went off to work and mothers stayed behind to tend to three or four children. For these women, cereal must have been heaven-sent. They could pour everybody a bowl of Corn Flakes, leave a milk carton out, and be done with breakfast, except for the dishes.

Now Americans have fewer children. Both parents often work and no longer have time to linger over a serving of Apple Jacks and the local newspaper. Many people grab something on the way to work and devour it in their cars or at their desks while checking e-mail. "For a while, breakfast cereal was convenience food," says Abigail Carroll, author of *Three Squares: The Invention of the American Meal*. "But convenience is relative. It's more convenient to grab a breakfast bar, yogurt, a piece of fruit, or a breakfast sandwich at some fast-food place than to eat a bowl of breakfast cereal."

People who still eat breakfast at home favor more labor-intensive breakfasts, according to a recent Nielsen survey. They spend more time at the stove, preparing oatmeal (sales were up 3.5 percent in the first half of 2014) and eggs (up 7 percent last year). They're putting their toasters to work, heating up frozen waffles, French toast, and pancakes (sales of these foods were up 4.5 percent in the last five years). This last inclination should be helping Kellogg: It owns Eggo frozen waffles. But Eggo sales weren't enough to offset its slumping U.S. cereal numbers. "There has just been a massive fragmentation of the breakfast occasion," says Julian Mellentin, director of food analysis at research firm New Nutrition Business.

And Kellogg faces a more ominous trend at the table. As Americans become more health-conscious, they're shying away from the kind of processed food baked in Kellogg's four U.S. cereal factories. They tend to be averse to carbohydrates, which is a problem for a company selling cereal derived from corn, oats, and rice. "They basically have a carb-heavy portfolio," says Robert Dickerson, senior packaged-food analyst at Consumer Edge. If such discerning shoppers still eat cereal, they prefer the gluten-free kind, sales of which are up 22 percent, according to Nielsen. There's also growing suspicion of packaged-food companies that fill their products with genetically modified organisms (GMOs). For these breakfast eaters, Tony the Tiger and Toucan Sam may seem less like friendly childhood avatars and more like malevolent sugar traffickers.

Bryant says Kellogg is laboring to develop cereals that will overcome these cultural shifts and end its morning misery. Some of Kellogg's wounds, however, are self-inflicted. Its two largest competitors—General Mills, maker of Cheerios and Lucky Charms, and Post Holdings, whose brands include Grape-Nuts and Honey Bunches of Oats—are struggling with the same morning trends. Yet the decline in General Mills' 2014 cereal sales was half as bad as Kellogg's, and Post eked out a 2 percent increase.

Kellogg's dismal sales are indicative of the company's larger problems. Of the 21 analysts covering Kellogg tracked by Bloomberg, 19 have a sell or a hold rating on the company's stock. Only two recommend buying the cereal maker's shares. It's cut costs, only to amp up spending again. There have been three heads of U.S. breakfast foods in four years as the division's profits fell. Bryant's latest scheme to revive cereal sales—by adding more fruit and natural ingredients to some of its best-known brands—seems far-fetched at best. The meltdown in Battle Creek is puzzling because, until recently, the company was known as a well-managed organization. "Kellogg was perhaps the most respected consumer-product company out there," says David Palmer, a food industry analyst at RBC Capital Markets. "They went off the rails."

Bryant frequently pays homage to his company's founder, Will K. Kellogg, the man who practically invented the modern idea of breakfast. Throughout much of the 19th century, Americans woke up in the morning and ate leftovers. Predictably, this caused widespread indigestion. Wealthy people often went to sanitariums for exotic cures involving enemas and hydrotherapy. Kellogg worked at just such a health spa in Battle Creek run by his older brother, Dr. John Harvey Kellogg, an eccentric wellness guru memorialized in the 1994 movie *The Road to Wellville*. The Kelloggs were Seventh-Day Adventists and therefore strict vegetarians. They couldn't serve their patients eggs and bacon. So in 1894 they came up with something lighter: corn flakes. "They developed a flaking process," says Brian Wilson, a professor of comparative religion at Western Michigan University and author of *Dr. John Harvey Kellogg and the Religion of Biologic Living*. "That's the origin of the modern breakfast flake."

The Kellogg brothers were soon quarreling about what to do with the invention. W.K. Kellogg wanted to make money. In 1906

“The company has been around for 109 years. We have the time. We have a plan to turn it around”

he founded Battle Creek Toasted Corn Flake Co., enlivening the taste of his cereal with sugar. His brother thought this was blasphemous. A legal battle ensued over who had the right to use the family name, and W.K. Kellogg prevailed. He introduced All-Bran in 1916. Rice Krispies followed in 1928. By then, Kellogg was a wealthy man known for his benevolence. He started a charitable foundation that supported children’s health and education. During the Depression, he changed the factories’ three eight-hour shifts to four six-hour ones to employ more people.

In 1949, Kellogg hired Leo Burnett, the rumpled advertising genius who created the Jolly Green Giant and the Marlboro Man. Burnett persuaded Kellogg to promote his cereals on television, then a nascent medium. His agency was responsible for many of Kellogg’s Disney-like cartoon characters. They became as famous as the ones in the Saturday morning shows sponsored by Kellogg, such as Yogi Bear and Huckleberry Hound. In fact, Yogi and Huckleberry sometimes cavorted in Kellogg commercials. Children, many of whom watched TV with a bowl of milk-soaked Kellogg’s Sugar Pops or Frosted Flakes, were entranced. They ate cereal for breakfast, cereal for lunch, and cereal for a bedtime snack.

Kellogg died at the age of 91 in 1951. By the 1970s, Kellogg’s share of the U.S. cereal market had reached 45 percent. The Federal Trade Commission said the company was too big and might need to be broken up. Nothing came of it. It was harder, though, for Kellogg to escape the consumer activists who criticized marketing junk food to youngsters. “Many of the kid-oriented cereals have a fair amount of sugar in them,” says Michael Jacobson, executive director of the Center for Science in the Public Interest, a food industry watchdog. “Their Eggo waffles are mostly white flour. Pop-Tarts are white flour and sugar. For a company that started out as a health-food company, they’ve turned into something very different.” (Kellogg says it has lowered the amount of sugar in its top-selling kids’ cereal by as much as 30 percent in the past several years.) As sugary cereals started to lose their broad appeal by the early 1990s, Kellogg forfeited its dominant position in the U.S. to General Mills, whose Cheerios were marketed as a healthier alternative.

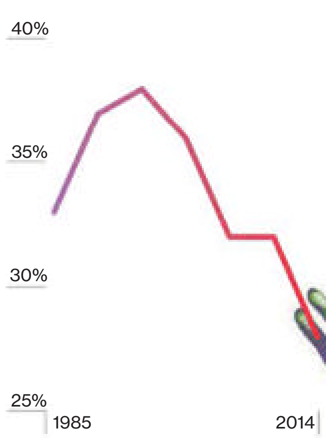
Kellogg’s fortunes rose again with the ascension of Carlos Gutierrez, a handsome Cuban-born executive with dark hair and a snowy mustache who began his career selling Frosted Flakes out of a truck to hole-in-the-wall stores in Mexico City. Gutierrez took over as the company’s CEO in 1999 and proved himself a gifted morning-food strategist. He believed that consumers would pay more for cereals they thought were better for them. He decided to push Special K, then a staid diet brand marketed to weight-conscious women. Kellogg spiced it up by introducing freeze-dried strawberries developed in the company’s Battle Creek food laboratory. Special K Red Berries became a best-seller, inspiring a plethora of extensions such as Special K Chocolatey Delight cereal, Special K Cracker Chips, and a Special K low-calorie pink lemonade mix.

Kellogg also paid $33 million in 2000 for Kashi, a health-food cereal maker founded by an enterprising jazz trumpeter and his wife in La Jolla, Calif. At the time, Kashi was bringing in $25 million a year. Less than a decade later, its annual revenue had climbed to $600 million. Gutierrez made a point of keeping Kashi based in Southern California to give it some indie cred. But now that it was a division of Kellogg, the health-food purveyor no longer behaved like a mom and pop venture. It introduced Kashi Chocolate Almond Butter cookies, Kashi frozen pizzas, and other items that seemed closer and closer to processed food.

In 2004, Gutierrez departed to become President George W. Bush’s Commerce secretary. After a two-year stint by James Jenness, a Kellogg director and former Leo Burnett executive, David Mackay, a balding, soft-spoken New Zealander and the company’s chief operating officer, took the top job.

Kellogg’s current problems began shortly thereafter. In 2008, Mackay embarked on a $1 billion, three-year cost-cutting initiative called K-Lean, which targeted wasteful spending

Share of American breakfasts that include cold cereal



DATA: NPD GROUP

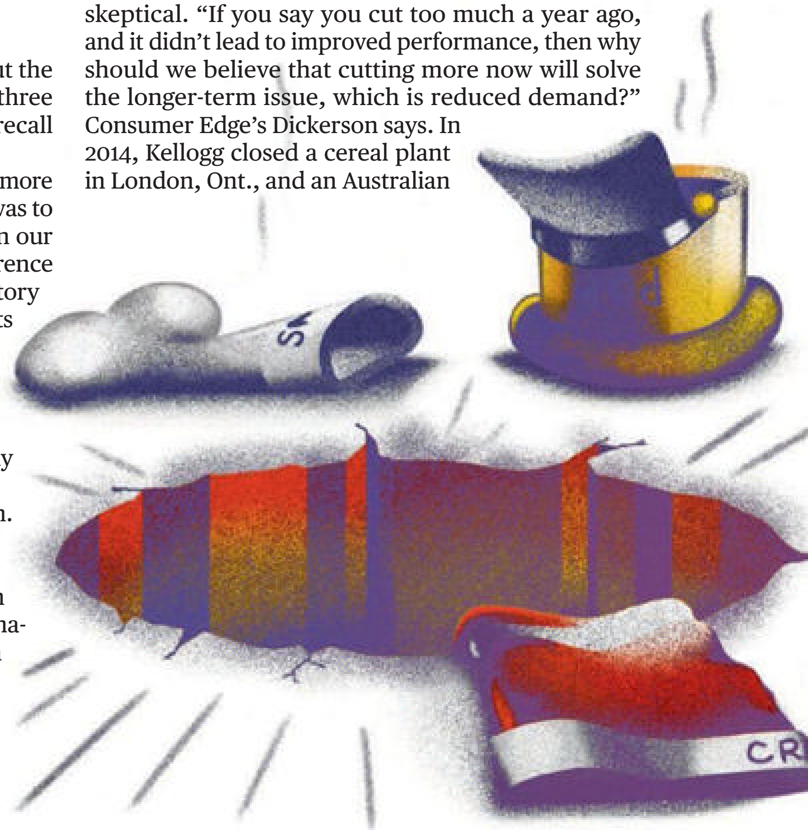
“For a while, breakfast cereal was conve
But convenience is relative”

in the company’s factories. It was soon clear that Mackay had gone overboard. A flood at an Eggo factory in Atlanta led to a debilitating frozen waffle shortage that battered the company’s financial results in 2009. The following year, Kellogg recalled 28 million boxes of Froot Loops, Honey Smacks, and others manufactured at its Omaha plant because of an odd stench and taste the company traced to the plastic lining in the boxes. Kellogg acknowledged that some customers started their day with these cereals only to be sidelined by nausea and diarrhea. “It was horrible,” says Trevor Bidelman, president of Local 3G of the Bakery, Confectionary, Tobacco Workers and Grain Millers International Union, which represents workers at the Battle Creek cereal factory. “They cut way too deep. Probably the biggest thing that hurt them was the thousands of years of experience that they ran out the door. Our plants could not run very effectively for two to three years after that.” (Kellogg says neither the flood nor the recall were related to K-Lean.)

By the end of 2010, Kellogg had replaced Mackay with the more gregarious Bryant, a 13-year Kellogg veteran. His first task was to clean up the K-Lean mess. “We did cut too many people in our facilities in the U.S. network,” Bryant admitted in a conference call in November 2011. He said Kellogg was hiring 300 factory workers and adding additional waffle capacity. Some analysts listening were astonished by the disarray in Battle Creek. “It seems like the more rocks that are turned over, there is more ugly stuff underneath,” Eric Katzman, a food industry analyst at Deutsche Bank, said at the time. “It’s amazing that a company like Kellogg, with its reputation, is actually going through this.”

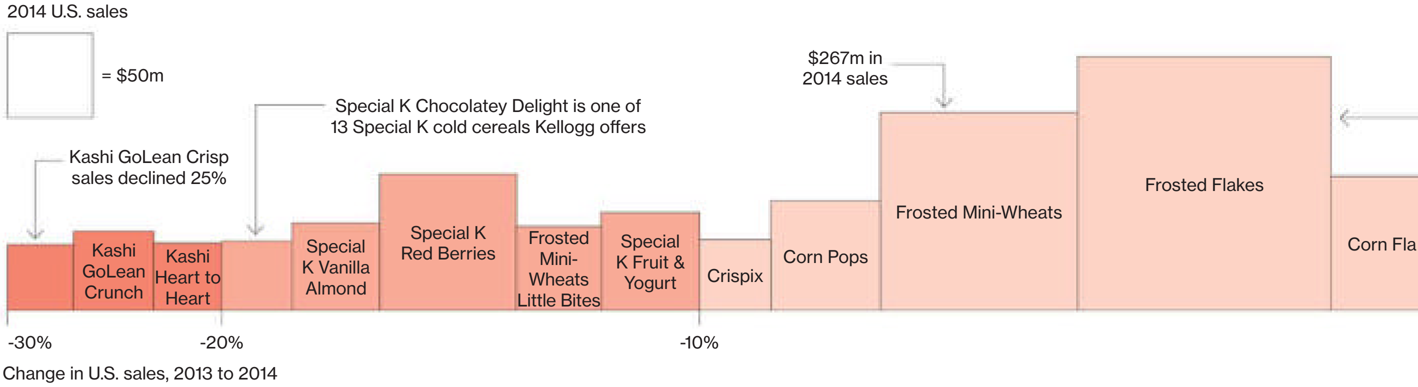
As Kellogg flailed, General Mills strengthened its position. That year, when many Americans were choosing yogurt over Cheerios, it paid $1.1 billion for a controlling stake in Yoplait, the world’s second-largest yogurt producer. As soon as he could, Bryant made what he considered a transformative purchase. In 2012 he orchestrated Kellogg’s $2.7 billion acquisition of Pringles, the 44-year-old canned potato chip brand, from Procter & Gamble. It’s hard to imagine a product more emblematic of the processed food that American consumers were shirking. But the deal boosted Kellogg’s net sales by more than $1 billion that year, to $14 billion, and enabled Bryant to claim that Kellogg was no longer so dependent on cereal.

Kellogg still counted on Frosted Flakes and its breakfast-food siblings for more than a third of its operating profits, which were dwindling. In November 2013, Bryant puzzled Wall Street by announcing a four-year cost-cutting plan with another memorable title: Project K. He vowed to eliminate 7 percent of Kellogg’s workforce and use a portion of the savings to create exciting new cereals, though he declined to provide further details at the time. Industry analysts were skeptical. “If you say you cut too much a year ago, and it didn’t lead to improved performance, then why should we believe that cutting more now will solve the longer-term issue, which is reduced demand?” Consumer Edge’s Dickerson says. In 2014, Kellogg closed a cereal plant in London, Ont., and an Australian



Kellogg’s Top 25 U.S. Cereal Brands

2014 U.S. sales



nience food.

snacks operation. Bryant has threatened to close one of its four American cereal plants this year if the bakers union won't accept a contract enabling Kellogg to hire a new category of "transitional" workers who would be paid lower wages and be ineligible for a pension. "It is not our preferred approach," Bryant says. "But if that's where we end up, that's a path we'll have to go down." So far the union has declined his overtures. Bidelman, a fourth-generation Kellogg employee, doesn't think the company's founder would have treated his factory workers so callously. "The philosophy of the company seems to have changed quite a bit," he says. Instead, Bidelman says, Kellogg should trim Bryant's compensation, which was $7.9 million in 2013.

Morning-food sales continued to fall in 2014. Some Special K spinoffs posted double-digit declines, and the Kashi line was a particular embarrassment. Kashi Heart to Heart fell 27 percent. Kashi GoLean Crunch lost 30 percent. Analysts say that part of the problem is Kellogg's indecisiveness with the division. In 2013 it moved Kashi from Southern California to Battle Creek, which Kellogg insisted would better position it for future growth. Then, last year, Bryant announced that Kellogg was moving Kashi back to La Jolla so the struggling unit would be closer to its roots. "Kashi is a brand that has lost its way," says RBC's Palmer. "Many of its varieties are not organic. Many have GMOs."

While Bryant attacked costs, his competitors added new cereals in response to consumers' shifting breakfast habits. In January 2014, General Mills announced GMO-free Cheerios. Post said it would release a similar version of Grape-Nuts. Kellogg says it can't do the same with Frosted Flakes because almost all the corn made in the U.S. is genetically modified.

In November, Bryant made a belated attempt to get some new breakfast fare to market, unveiling a gluten-free Special K in an earnings call. He arguably went off message, however, by making a big deal out of a new peanut butter and jelly Pop-Tart. "If I ask you do you think peanut butter and jelly Pop-Tarts are where United States food culture is headed, the answer most likely is no," Dickerson says.

In February, Bryant acknowledged that Kellogg's U.S. snacks division was also ailing. Last year its sales declined 2 percent. This put even more pressure on him to resuscitate the cereal division, so Bryant has been pushing what he describes as a long-term rescue plan. He wants to rebrand Special K from a diet brand to a cereal for the health-conscious with new variants such as Special K Protein Cinnamon Brown Sugar Crunch. The company is also promoting Raisin Bran with Cranberries. Bob Goldin, executive vice president of Technomic, a food industry consultant, doubts that these new cereals will have a big impact on the company's sales. "The category is pretty mature," Goldin says. "It's not so easy anymore to introduce a new line or do a new TV ad and life is good again."

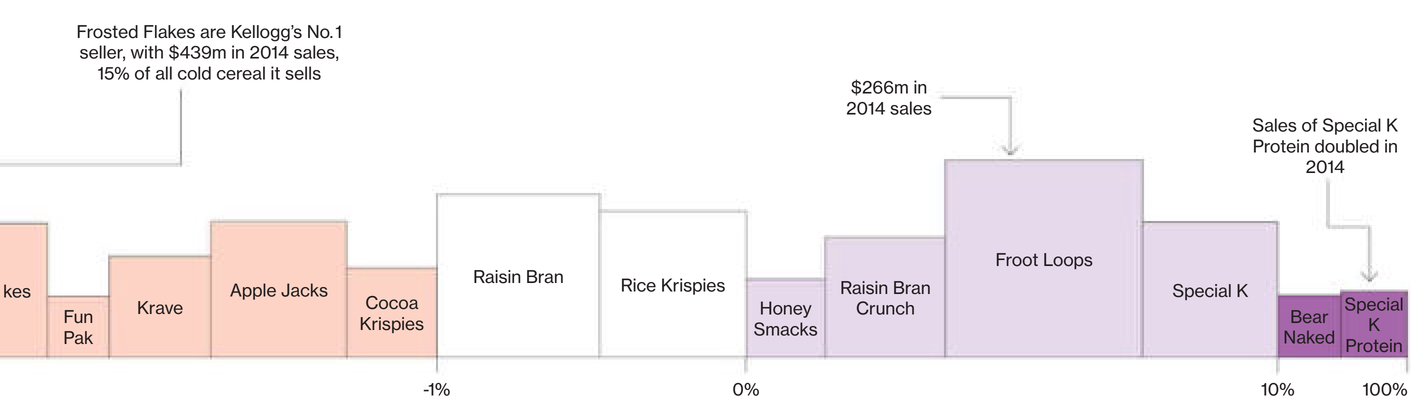
Bryant is also determined to restore Kashi's credibility with health-food shoppers. Kellogg already has 15 GMO-free cereals in supermarkets. It hopes to add more this year. At the same time, Kellogg's less publicized political maneuvers aren't helping it with anti-GMO consumers. In California, Washington, and Oregon, Kellogg is spending $1.4 million to defeat ballot initiatives that would force companies to identify GMO ingredients on their labels. Alexis Baden-Mayer, political director of the Organic Consumers Association, says Kellogg is alienating customers: "It seems counterintuitive." Kellogg says state-by-state labeling would confuse shoppers and increase costs.

Focusing on Special K and Kashi comes with the risk of neglecting older brands—the ones keeping Kellogg afloat. Even though Frosted Flakes is hardly a next-generation breakfast product, the company sold $439 million worth last year, making it the second-most popular cereal in the U.S. after General Mills' Honey Nut Cheerios. What's more, Kellogg increased Froot Loops sales by 3 percent, to $266 million, by marketing the technicolor rings to adults as a late-night snack. "These are not dead brands," says Mary Zalla, global vice president of Landor Associates, a branding adviser. "There's amazing equity in Kellogg's name. Then they've got this other whole layer of value: the characters. Sometimes they have longevity. Sometimes they don't. But think of Ronald McDonald."

Bryant isn't worried. "The company has been around for 109 years," he says. "We have the time. We have a plan to turn it around." He better show results in a hurry. The consensus on Wall Street is that Kellogg is a takeover candidate. "He's at a critical point in his career," says Palmer of Bryant.

Perhaps it's time for the CEO to imagine what W.K. Kellogg would do. It's doubtful the company's founder would let things get so out of control at his factories. It's hard to think of him taking away employee benefits. He wasn't a trend follower: Kellogg created breakfast flakes and foresaw the power of TV advertising. There must be some way for his successors to sell breakfast food to working parents and their children who are now watching YouTube instead of Saturday morning cartoons. Bryant could always triple his All-Bran Buds consumption and entice his children to eat more cereal, too. It may not save Kellogg. But at least he'll be able to say he went down fighting. B

—*With Matthew Boyle*

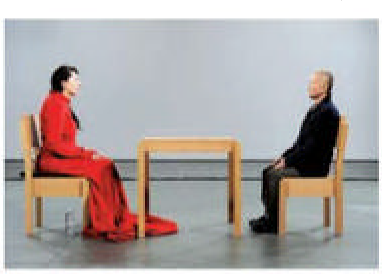


DATA: CONSUMER EDGE RESEARCH

It Ain't Easy Being a Performance Artist

Marina Abramovic's bizarre struggle to turn her art into an institution, a legacy, and decent money
By Caroline Winter

For nearly three months, Marina Abramovic sat on a wooden chair in New York's Museum of Modern Art, six days a week, 8 to 10 hours a day, barely moving and never getting up, not even to eat or go to the bathroom. Her shoulders ached, her legs and feet swelled, and her ribs felt as if they were sinking down into her organs. The punishing performance transformed her into an international celebrity and one of the world's most famous living artists.



Carrying the Skeleton I, 2008. Some of Abramovic's photographs, like this one, are staged rather than shot during actual performances.

More than half a million people came to see the 2010 exhibit, titled *The Artist Is Present*. In addition to Abramovic herself, the retrospective featured rooms filled with films and photographs documenting works she'd created over four decades. Some 1,500 visitors, including Sharon Stone, Bjork, and Lou Reed, waited in line, and sometimes through the night, to sit across from the artist and bask in her gaze.

"Why did I have to kill myself for three months?" she would later ask. "I wanted to show the power of performance art, wanted to show how it can touch people's hearts."

Despite her fame, an Abramovic original isn't expensive—at least, not compared with contemporaries such as Jeff Koons, Damien Hirst, and Gerhard Richter. While a single Koons sculpture fetches as much as $58.4 million at auction, Abramovic's biggest sale to date was one of her material works, a 1996 sculpture called *Chair for Non-Human Use*, which sold for $362,500 in 2011, according to Artnet, which tracks the art market. The chair has a quartz crystal backrest and iron legs that are 23 feet long. As for *The Artist Is Present*, Abramovic says she prepared for a year, sat for a total of 736 hours, and needed three years to recover from the physical and mental toll. Her fee, she says, totaled $100,000.

SEVEN PRINTS SOLD FOR $61,721 IN 2007

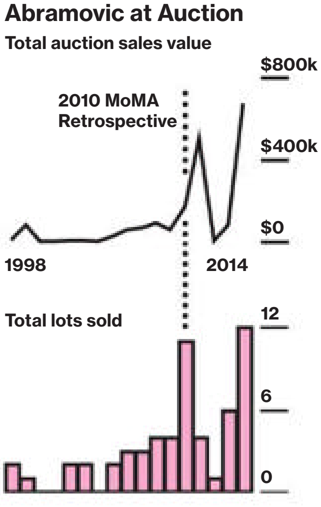
Relation in Space, 1976. At the Venice Biennale, Abramovic and Ulay, her lover and co-performer, repeatedly slammed into each other for an hour.

Performance art has never been an easy way to make a living, even by the dire standards of artists. Collectors can't hang it on their walls or, perhaps more important, sell it at a profit. The form is innately ephemeral and self-consciously defies definition; many of the medium's stars, including Abramovic, make works based on time, space, their own bodies, and their relationship to an audience. That's hard to auction, though it's been done.

Most of the early stars of performance art, which has been practiced since the Renaissance but first gained mainstream attention in the 1960s, have retired or refocused on more profitable media, such as sculptures and paintings. At 68, Abramovic is an exception. "Marina has done more than anybody to define what performance art is and what it can be," says Julia Peyton-Jones, director of London's famed Serpentine Galleries. "She is a kind of guiding light. She shows us all what is possible." In recent years, she's been the subject of a biography, a documentary, an opera, and a video game. Even hip-hop superstar Jay Z got caught up in the lovefest, staging a kind of tribute to her by rapping his song *Picasso Baby* over and over in a gallery for six hours.

"There is this contradiction," says Abramovic, who has a pronounced Serbian accent. "I'm very high on every art list or whatever, but as for market value, I'm less than any mediocre, how do you call it, young art."

Abramovic at Auction



DATA: ARTNET

Until recently, Abramovic's relatively low earning power wasn't a problem. Her art income is enough to support four employees and two freelancers, although she's quick to point out that "Damien Hirst has 240, you know." She owns a loft in SoHo and a star-shaped country home in Malden Bridge, N.Y., acquired with money she made off one lucky real estate play. But now Abramovic, who's never professed much interest in money, is trying to raise some $31 million for her planned Marina Abramovic Institute (MAI), a nonprofit organization to be located in a derelict 33,000-square-foot former indoor tennis center in Hudson, N.Y. The building's redesign is being led by Rem Koolhaas and Shohei Shigematsu of the architectural firm OMA. They aren't cheap, and they aren't donating their time, as many of Abramovic's famous friends do when she asks for help.

Abramovic hopes the institute will be her legacy, a platform for performance art, and a destination for artists, scientists, and thinkers. Admission will be free, she says, and visitors will be invited to don white lab coats and take part in the "Abramovic Method," a series of exercises designed to improve focus, endurance, and sense of self. These include, for example, walking backward through the woods for hours while looking into a hand mirror. "If I can change human consciousness, even the slightest bit, this is my job," she says.

"Basically w
money for p

But changing consciousness and raising millions are endeavors not often in sync, as Abramovic found last December at Art Basel Miami Beach, arguably the world's most important intersection of art and commerce, attended by everyone from billionaire Steve Cohen to pop star Miley Cyrus. There, Abramovic hosted a number of events to raise awareness for her institute, but failed to raise any money. She had visitors take naps on cots in the art fair's convention center, surrounded by billions of dollars worth of art, and taught them to walk in slow motion, taking up to an hour to complete a loop that would ordinarily take less than a minute. She encouraged them to sit at tables designed for Abramovic by architect Daniel Libeskind and participate in an exercise called Counting the Rice, which involves sorting uncooked lentils and rice grains for a minimum of six hours. ("How do you write 1 million million million million?" asked one 5-year-old girl, looking to document her progress after 10 minutes.)

A PRINT SOLD FOR $25,000 IN 2008

Rhythm 10, 1973. Stabbing between her fingers in this audiotaped performance, Abramovic picked up a new knife every time she cut herself.

One evening, select invitees, including artists, music industry agents, and collectors, muted their phones and rode an elevator to the seventh-floor lounge of the National YoungArts Foundation's headquarters in Miami. They spent more than an hour in silence, sipping pinot grigio and munching, as quietly as possible, on truffle oil chips and popcorn. The artist was conspicuously not present, but no one was crazy enough to break the gag order and ask why. Finally Abramovic breezed in, dressed all in black, as she usually is, except for red shoes. "I'm sorry to be late, I'm so sorry," she

**ve would go from place to place, and the amount of
performance was $150, $50, $60, or nothing”**

declared. It turned out she’d been stuck in traffic caused by protesters for nearly two hours. “I hope you enjoyed your silence,” she continued with a sly smile. “Thank you for trusting me to do all these strange things.”

Two weeks after Art Basel Miami, Abramovic is back in her SoHo loft, a modern flat with a spacious living room and an enormous walk-in closet filled almost exclusively with neatly hung black clothing. “The best part is the bathtub,” she says. “I mean look, it’s enormous.” In person, Abramovic is motherly, generous in nature, and, for the most part, calls everybody “baby” (as do her assistants). Her pale skin is unlined, and she has long black hair and full, slightly crooked lips. “Do you want a cappuccino?” she asks, before settling into a designer couch made from quilted gray cloth. “Illy gave me this beautiful machine. I’m not making it so perfect yet. I’m learning.”

Many of Abramovic’s belongings are gifts, it seems. Her close friend Riccardo Tisci, creative director at Givenchy, supplies her with clothing. On the floor in the living room sits a pile of crystals, including one the size of a football, given to her the previous night by Lady Gaga, who has been using the Abramovic Method to help cut down on smoking and anxiety. According to Abramovic, Gaga now carries rice and lentils with her everywhere. They’d been at a party for James Franco, and David Blaine, an old friend, helped Abramovic lug the crystal home.

Abramovic was born in Belgrade, the capital of what was then Yugoslavia. Her parents were national heroes who fought the Nazis during World War II and were rewarded with high positions in Josip Broz Tito’s communist government. Privileges included foreign travel, a seaside villa, maids, and lessons in French, English, and piano. But Abramovic’s parents fought incessantly, and her father left the family for another woman. Her mother, Danica, was severe and unsympathetic, subjecting her daughter to a strict 10 p.m. curfew until well into her 20s.

Partly in response to her “militaristic” upbringing and a growing interest in political protest, Abramovic began experimenting with performance art at Belgrade’s Student Cultural Center. During the ’70s, she performed a series of extreme works. She screamed until, three hours later, she lost her voice. She danced for eight hours until she collapsed. She created

a giant star from wood chips, lit it on fire, then lay amid the flames until she passed out from lack of oxygen and had to be rescued by onlookers. In *Rhythm 0*, one of her most famous pieces, Abramovic placed 72 objects on a table, including nails, a rose, perfume, a bullet, and a gun, and gave her audience permission to use them on her. Over the course of six hours, they kissed her, cut her clothes, and put a knife between her legs. One person loaded the gun and placed it in her hands.

On her 29th birthday, Abramovic met Frank Uwe Laysiepen, a West German artist known as Ulay, and fell in love. A few months later, she ran away to Amsterdam to be with him. They collaborated for the next 12 years, five of which they spent living in a black Citroën van. "We didn't need to pay electricity, we didn't have telephone, we didn't need to pay for apartment," says Abramovic. "Basically we would go from place to place, and the amount of money for performance was $150, $50, $60, or nothing."

The couple also worked many odd jobs. "We milked the goats in Sardinia to get sausages and bread.... We made [sweaters] and sell them on the market," says Abramovic. For one month, Abramovic even worked as a mail carrier in London—which didn't end well. "First it took me so long time to deliver all the letters," she says. "And I decide that every letter who was written with typewriter machine must be bad news or a bill, and I throw them away. And I only deliver letters written by hand and become much faster. Only beautiful letters. After four weeks working, they could not prove anything, but they asked me to give back uniform, which I did."

Rest Energy, 1980. Abramovic and Ulay lean back to create tension in the bow. Meanwhile, small microphones attached to the artists' chests record their quickening heartbeats.

Abramovic says she never got money from her family after leaving Serbia but didn't worry about finances. "I never felt I was poor," she says. "How can I explain, I always had this feeling that I'm OK, you know? Even if I didn't have the money, I never had the panic like other people or made compromises." After Ulay got involved with another woman, the couple agreed to create one last performance together in 1988. Funded with a grant from the Dutch government, they spent three months walking toward one another along China's Great Wall from opposite ends and finally met to say goodbye. Heartbroken, Abramovic returned to Amsterdam and began teaching at various art academies across Europe. "There were moments where I wake up and wanted to switch on light, and there was no light because I didn't pay bills, or no heat," she recalls. "I just lie on the bed and laugh and laugh and laugh and think this is really disaster but, OK, let's start the day and see what I can do."

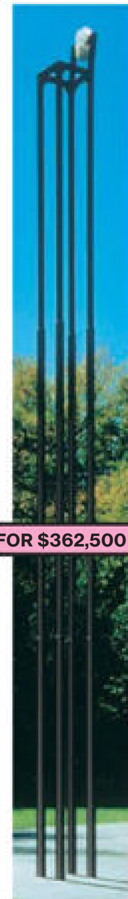
In the early '90s, Abramovic had lunch with a gallery owner, Sean Kelly, at a cafe on Spring Street in SoHo. "I knew of Marina and had spent a number of years trying to avoid her," recalls Kelly. After all, her unconventional work was hard to sell. But she persuaded him to represent her, and they have worked together since. (She's also represented by three other galleries around the world.)

"I knew that if I met her, I would end up working with her," he explains. "And I hadn't figured out how the hell I could support that practice."

$2,500+ PER SEAT DINNER

Early on, they began mapping out a strategy for her career. Their first move was to print and frame 12 stills from Abramovic's pre-Ulay performance pieces, which sold to "enlightened, philanthropic collectors" for as little as $3,500, says Kelly. Early investors were likely looking to support Abramovic rather than turn a profit, but those same works now fetch about $45,000.

With Kelly's guidance, Abramovic also began creating objects to sell alongside her performances. "Sometimes it would be a photograph, sometimes a video.... The scale would change and whether it was in black and white or color." Over the next decades, Abramovic's prices rose considerably. "The early video pieces in small editions are €150,000 or €250,000," says Kelly. "The photographs are normally up to about €100,000." In October the gallery staged her latest New York exhibition. Viewers were made to put on blindfolds and headphones before being led into a space and left there, blind and deaf, to do as they pleased. They couldn't see or buy anything. "There's nothing to capitalize on," Kelly points out. "It was free to the public, I paid all the bills...but we recognize that it's a big-picture long-term investment in her as a brand."



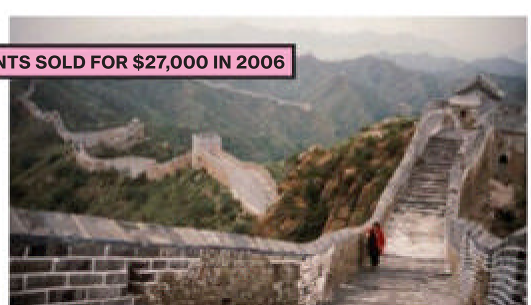
SOLD FOR $362,500 IN 2011, AN ABRAMOVIC HIGH

Chair for Non-Human Use, 1996. Roughly 23 feet tall, the chair has a quartz crystal backrest.

"People have

It is possible for "immaterial" artists to make money off the performance itself, of course. In the late 1950s and early '60s, French conceptual artist Yves Klein sold a series of "immaterial zones," or empty spaces within Paris, in exchange for gold. His patrons would then watch as he threw half of the payment into the Seine; the transaction was completed when the purchaser burned a certificate of authenticity confirming the amount of gold transferred. Contemporary British-German artist Tino Sehgal has sold several performance pieces to museums, including MoMA and the Guggenheim. He provides no written contracts, insists that the directions for reenacting his works be delivered via word-of-mouth, and requires that collectors never photograph or film his "constructed situations." Online auction house Paddle8 last year sold a one-time performance by Icelandic artist Ragnar Kjartansson for more than $36,000.

Like many artists, Abramovic has taken the corporate dollar. Last summer she collaborated with Adidas, lending the shoe company one of her and Ulay's 1970s works, *Work/Relation*, for a World Cup commercial. In the three-minute, black-and-white film, 11 performers wearing Adidas sneakers demonstrate that the most efficient way to carry stones from point A to point B is through teamwork. "Marina Abramovic, sellout?" asked *New York* magazine after the commercial aired. The magazine was not her only critic.



12 PRINTS SOLD FOR $27,000 IN 2006

The Great Wall Walk, 1988. To end their 12-year relationship with a performance, Abramovic and Ulay started at opposite ends, met, then said goodbye.

CLOCKWISE FROM LEFT: COURTESY THE MARINA ABRAMOVIC ARCHIVES (2); JEFF VESPA/GETTY IMAGES FOR MOCA; GIANNI ANTONIALI/IKON; COURTESY CAROLINE WINTER; COURTESY THE MARINA ABRAMOVIC ARCHIVES

An Artist's Life Manifesto, 2011. For this event, Abramovic created human table décor.

Abramovic was surprised by the reaction and insists she did the ad primarily for exposure and to reach an audience that might not yet know about performance art. She was paid about $150,000, she says, and spent $50,000 producing the film, a pittance compared with Kanye West's reported $10 million contract with Adidas or basketball star Kevin Durant's $300 million deal with Nike. "I'm not sorry," says Abramovic. "It was the right thing to do for my institute." In the past, she points out, art was sponsored by the pope, aristocrats, and kings. They don't seem as interested in art anymore. "Now it's sponsored by industry and by individuals–that's the reality." As for endorsing Adidas, she says, "People have to wear shoes, so what's the problem with black shoes with three stripes. I don't get it. ... People have very old-fashioned view that artists should have nothing, for some reason. But I don't understand why I should be paid less than the plumber who comes to fix your toilet." Unlike most plumbers, however, Abramovic is in demand on the lecture circuit, and her fee is around $15,000.

very old-fashioned view that artists should have nothing"

It's in real estate, however, that her appetite for strange situations truly pays off. "I have an intuition for real estate, just like for art," she says. "You know, it's so interesting, the basic money, it doesn't come from my sales. It comes from completely another story." In the late '80s she bought a run-down, six-story house in Amsterdam that had been seized by a bank. "It was terrible," she remembers. "I mean, baroque ceilings, beautiful cast marble fireplaces, but like 35 heroin addicts living there."

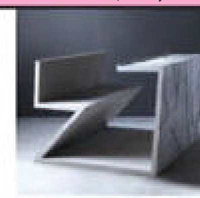
CONSTRUCTION COSTS UNCLEAR

Future site of the Marina Abramovic Institute in Hudson, N.Y. The former community tennis center, which Abramovic bought for about $1 million, may cost up to $31 million to renovate.

Abramovic had $5,000 for a down payment, which she'd earned selling Polaroids she shot with Ulay, but she needed a mortgage. Banks weren't interested, she says, explaining that Dutch law is protective of squatters. Abramovic went to neighbors for help, and finally someone explained that a drug dealer lived on the second floor and kept the addicts there so no one would buy the place. As Abramovic recalls, "The next day, I go, and I ring the bell, and this guy opened the door, and I go up, and there is like a table full of every kind of coke, heroin, grass, LSD, ecstasy, and a pistol on the floor. And he's looking at me with bloodshot eyes and says, 'What do you want?'"

Marina sat down and poured out her heart. Finally, as she tells it, the dealer said, " 'OK, I think I like you, so this is the deal we're going to do: I will get the old guys out. You will get the mortgage, and you buy this house, but then you have to come to me with a contract for the lowest social rent, and I can stay forever.' "

ONE SOLD FOR ABOUT $100,000 IN 2014



Counting the Rice table, 2014. Daniel Libeskind designed this desk for free to help raise money for the Marina Abramovic Institute.

Abramovic took the deal, and when she returned the next day the heroin addicts were gone. "I take the huge rubbish container, and I throw everything out: old curtains, furniture, s---," she says. "The third bank I call gave me the mortgage." To make sure no one snapped up the house before the contract was signed, Abramovic had the drug dealer temporarily move a few heroin addicts back in. "I told him, about 15 will do." Over the next 25 years, Abramovic says she put roughly $30,000 into the place. The drug dealer and she became friends; he cleaned up and ultimately moved out. Years ago, she sold the house for roughly $4.5 million and bought a series of New York properties, some of which she later sold at a sizable profit, including one apartment that earned her at least $350,000.

She also bought the institute, a grand brick building in Hudson, a formerly down-on-its-luck upstate town now haggling with gentrification. The structure was previously a theater, then a sports center, and the inscription above the entrance still reads "Community Tennis." White paint is flaking off its four Corinthian columns. Abramovic has donated the structure, which she bought for close to $1 million, to MAI, her nonprofit, which is currently headquartered in a shared office in Manhattan. In terms of fundraising for the project, Abramovic says she's "nowhere. Seriously." In 2013 she completed a successful Kickstarter campaign, in which donors were awarded with hugs and Marina swag. The posted reward for those who gave $10,000: "Marina will do nothing. You will do nothing. You will not be publicly acknowledged." The campaign raised more than $661,000, but that money won't even cover Koolhaas's preliminary designs. Proceeds from the Adidas commercial, meanwhile, covered only a few months of operational costs.

In November, Thanos Argyropoulos, a Greek financier who is producing one of Abramovic's film projects, volunteered to come on as MAI's managing director. His résumé includes a stint as adviser to Greece's Ministry of Culture, where he says he helped slash the budget. "Wherever I show up, it means there's trouble–something needs restructuring," he says.

Argyropoulos is donating his time, because he's a fan of performance art and says Abramovic could use the help: "To put it in business school terms, Marina would ace strategy but fail corporate finance." He thinks the $31 million figure is, maybe, a bit high and that building costs can be reduced to as little as $7.5 million. "We perhaps did not need such a pharaonic, spectacular headquarters," he explains. To pay for upkeep and operations, Argyropoulos says MAI will earn money by hosting international performance art events and workshops abroad.

In the meantime, Abramovic abides, undaunted. "If I'm not able to get the money to make the institute run, I will make workshop with entire city of Hudson, for free of course," she says. "I can always go back to immateriality." B

SHADOW BANKER

HOW AN UNDOCUMENTED IMMIGRANT WENT FROM SELLING FUNNEL CAKES IN TEXAS TO DERIVATIVES AT GOLDMAN SACHS

BY MAX ABELSON
PHOTOGRAPH BY JOÃO CANZIANI

Sitting at her desk at Goldman Sachs, Julissa Arce is doing her best to keep it together. It's September 2007. Her father is dying in Taxco de Alarcón, a small and hilly city in Mexico, and she has just hung up after a call from her sister with bad news. Arce stands and leaves the row where she and her colleagues create derivatives and market them to rich people. She walks down the hall, opens the bathroom door, and locks herself in a stall.

"Do not be anxious about anything," she says under her breath, repeating Philippians 4:6. "Do not be anxious about anything." Then she straightens, washes her face, and returns to work. Her banker colleagues can't understand why she won't get on a plane to see her father. Arce tells them that her family will keep her posted, and she might be leaving tomorrow. There is no crying on the private wealth management floor.

The overachievers at Goldman Sachs aren't all the same. Some have been valedictorians, or Navy SEALs, or the sons or grandsons of the company's bankers. Some will stop at nothing to amass a fortune; others are patient. And at least one was an undocumented immigrant. Arce, who turns 32 in March, owed her bright career on Wall Street to fake papers bought for a few hundred dollars in a stranger's living room in Texas. Over seven years at Goldman Sachs, she rose from intern to analyst, associate, then vice president, later becoming a director at Merrill Lynch. When her father died in Taxco hours after the 2007 phone call, she didn't leave to see her family because with her bogus papers she couldn't have come back.

Arce was 11 when she moved to San Antonio from Mexico. Despite arriving with little English, she joined the basketball, softball, cross-country, and dance teams, the student council, a Renaissance club, and two honors societies within a few years. She's still intense. She likes *The 7 Habits of Highly Effective People* and *How to Win Friends & Influence People* and is eager to explain, without irony, why they're illuminating. She does CrossFit and can hold 150 pounds behind her head. "You have to have a very A-type personality," she says about weightlifting, sipping a beer at Ulysses, a bar three blocks south of Wall Street. "This workout—*it's* not going to win. *I'm* going to win."

She didn't have to adjust to Goldman Sachs's culture of undisguised ambition, because she embodied it. A few weeks into her first summer there, as an intern in 2004, before her senior year of college, she arranged to have coffee with a managing director whose team she admired. She told him she had learned a lot and was ready for something faster. "I want to play basketball and go up and down the court," she told him. When she followed up with a handwritten thank-you card at the end of the summer, the managing director told her to expect good news.

A sharp kind of dread sank in after Goldman offered her a full-time position. She was afraid of what could happen when one of the world's most sophisticated companies examined her fake green card and Social Security number, took her fingerprints, and ran a background check. She had a recurring dream about being caught: She was sitting in an investment bank office. No one had to tell her she was being deported or threaten her; she just knew what was to come next. Then she'd wake up.

But Goldman never did discover her secret. It was 2005 and a good time to become one of the 23,000 employees of Wall Street's most profitable securities firm. "I was like, sky's the limit," she says. "I'm in."

Taxco is about 100 miles southwest of Mexico City. Arce remembers houses all painted white, tourists who flocked there for the silver work, and a dubbed version of *Dennis the Menace* called *Daniel el Travieso*. In one episode a flatbed truck moves the mean neighbor's house, and in another he drives an RV. "So when I was a little kid in Mexico my aspiration in life was to live in a mobile home like the Americans," she says. "Then when I got here I was like, 'Oh!'"

Her parents left Taxco regularly to sell jewelry in Texas. They got her a tourist visa so she could join them, and on one trip the family simply stayed. They moved into an apartment in San Antonio and then a house one block from the interstate. She went to a local Catholic school and took to math right away, eventually placing in the honors track. She remembers a classmate raising his hand to ask how a Mexican could possibly keep up.

Arce was 14 when her visa expired. "I knew what that meant," she says. "I became undocumented." Desperate to stay in the country she had come to love, she pitched her parents on a plan to have her friend Tiffani's family adopt her. The Arces didn't go for that, or her halfhearted suggestion at age 16 that they pay a gay U.S. citizen who worked with the family to marry her.

She also wanted to be rich. "I just had this idea in my head that if I can work my way into this wealth and status, then it won't matter that I'm undocumented," she says. "I thought if I had a bunch of money I would be accepted."

In her senior year of high school, Arce sent out college applications with the Social Security box blank—and got rejections. Just as she was graduating in 2001, a new law made it possible for undocumented Texas students to attend public universities at in-state rates. Five weeks later the director for admissions at the University of Texas at Austin wrote to say her application had been reviewed and she'd been accepted.

She majored in finance. The equations "made sense to me," she says. "There was always a right answer. There wasn't anything ambiguous about it. There was so much ambiguity in my life that I really appreciated that." Antonia Bernal, a leader of the Hispanic Business Student Association, which Arce joined, describes her at the time as vibrant and driven. Arce hadn't seen many Hispanic men wearing business suits before joining the club, and she still does a Hollywood swoon when she describes them. Meetings with successful women were just as important. "I could be ambitious and go-getter without seeming greedy and aggressive," she says. "There are all these amazing jobs, and there's all this money to be made." When the group handed out awards one April, it named her its Future Millionaire.

Arce's parents moved back to Mexico in 2001, and she took over a food cart business they left behind. Every Friday she rode a Greyhound bus 80 miles to San Antonio's Market Square to sell funnel cakes with strawberries, whipped cream, and cinnamon. Every Sunday she returned to Austin with money for rent and school.

When the cart lost its spot, Arce couldn't land a new job with her expired tourist visa. And she couldn't stay in college without a job. Getting a fake green card turned out to be unexpectedly simple. She confessed her need to a suitemate, who connected her to her boyfriend, who introduced her to a woman, who asked her to come to her home. It was a mundane transaction, Arce says, in an average apartment with an average living room. She handed over the money, had her picture taken, and about two weeks later had the forged documents.

They worked. Arce used them to land customer service work on nights and weekends for a debit card company in Austin and interned for a Major League Soccer team. Then she saw a presentation about summer positions at New York banks. The pay could be $10,000.

"Oh my," she remembers thinking. "That is where I need to go, and that is where I need to be."

The most influential document at Goldman Sachs may be a list of 10 business commandments written by co-head John Whitehead, who died

“I THOUGHT IF I HAD A BUNCH OF MONEY…

2

1

this year at 92. “Important people like to deal with other important people. Are you one?” No. 8 asks. “Don’t waste your time going after business we don’t really want,” says No. 1. By putting the Goldman thirst for competence, connection, rank, and respect into words, Whitehead set the strike zone for hitters at the bank, including ones born long after he retired in 1984.

The chances of joining them, with 350 summer analysts chosen by the investment banking unit from 17,000 applicants in 2013, are worse than the odds of getting into Harvard University. For those who do make the cut, the competition—for assignments, pay, power—only intensifies. Women do this battle knowing that 9 of the company’s 10 executive officers are men.

Arce got a 2004 internship through a nonprofit called Sponsors for Educational Opportunity, which places Hispanic and black students into summer roles at banks. She liked it at Goldman, where she helped put together presentations for existing clients and searched for new ones among the names of yacht owners. She was asked to return to the firm full-time after graduation in 2005. In New York her career got off to an extraordinary start when she was invited to join a new team that built derivatives for the private wealth division’s clients. These were financial products that might, for example, include options whose value would rise 3 percent for every percentage point that an index gained, up to a cap. Arce became a rookie analyst reporting directly to a managing director, making it to the office by 7 a.m. to beat her boss, eating a peanut butter and jelly sandwich for breakfast.

If there’s something valued more deeply at Goldman than separating the irrelevant from what matters or anticipating issues before they erupt, it might be the dogged pursuit of opportunity. An early performance review praised Arce for all three. She talked to bosses months in advance about what she had to do to make their yearend decision to pay or promote her as easy as possible. She was so forceful that a boss once told her to laugh less loudly, advice she still doesn’t follow when discussing ex-boyfriends or her cats, Pancho and Nikko. Her uniform was so consistent that colleagues donned sweater vests and scarfs for a photo tribute.

She was also willing to do what others wouldn’t. One week, when she was calling colleagues to get a price for a deal, teammates listened as she began raising her voice to a senior colleague she thought was making a bad offer. Then she started yelling. In the end, a boss sided with Arce.

“Julissa is the type of person that a Wall Street firm wants,” says a former co-worker, Jodi Salsberg. “Somebody who is incredibly driven and hardworking and fiercely loyal to the firm.” Clients started asking for her, according to another former colleague, Bryan David Hughes. She looked after younger colleagues, too. “There are a lot of smart people, and the expectation is you should get it the first time,” says Hughes, 30. “Julissa was the person I could go to and say, ‘OK, Julissa, explain it to me for the 10th time.’ ”

Arce and her friends liked to sit back at Ulysses and watch Goldman guys attempting to flirt with women. If a banker came up to her and name-dropped the firm, she would ask what exactly he did there and try to stay polite when he answered that she wouldn’t really understand. If he asked about her, she would cordially explain that she structured derivatives at Goldman Sachs for its richest clients.

Perhaps the biggest reason Arce’s secret went undiscovered was that no one was looking. At this altitude, people assume their friends belong. Mark Campbell, who had been hired at the same time, says he knew Arce was from Mexico, and it never occurred to him to question her citizenship. “It seemed to me that she had it all figured out,” he says. “You just sort of assume everything is fine.”

He explains his reasoning with a story about working construction in college, before joining the bank. When someone showed up at a site in a suit one day, workers bolted, thinking he was from the government. “Those were the people who were undocumented immigrants that I knew,” says Campbell, who now works for Morgan Stanley. “I think of people who are here to work in service-related jobs and work their way up for the next generation—but not here to become masters of the universe.”

Some days, Arce was tormented. “I don’t feel alright,” she wrote in a July 2008 diary entry. “I feel the stress in my stomach, in every muscle.” At Goldman international experience was crucial, and she knew that her fake papers wouldn’t withstand a border crossing. After a clash with a colleague based in London, he suggested it might be good for her to spend some time at the U.K. office. Yes, she told him, that makes sense. She stalled. When her own boss was transferred to London, Arce was afraid that the company would ask her to join him—and at the same time furious that she couldn’t pursue the opportunity.

In 2008 the global financial system was on the verge of collapse, Goldman’s clients were jittery, and the firm was losing money. When Arce opened her mail one day that July, she found a letter from the IRS asking about her tax filings. An operations manager for a unit called Input Correction wanted “more information to process the return accurately.” She put it in her closet and tried to forget about it.

“It was terrifying,” she says. More letters arrived; she shelved them, too. “You sort of have to force yourself to live in this alternate reality, just pretending like it doesn’t really exist.”

Arce’s anxiety would spike when a colleague looked at her weirdly, or if she was suddenly called into an office. “This is it,” she always thought. One day, distracted, she made a mistake on a Japanese

COURTESY JULISSA ARCE (4)

trade for a client. She thought her career might end.

Other times she was too busy to worry. She thought it was taking too long to get promoted to associate, and as soon as that came through, she went to work on becoming a vice president. And she started dating someone she had met in college. She liked that he was strong and good at pool, and she felt safe around him, she says.

After her father died in 2007, she thought about taking some of her things on a flight to Mexico and not coming back. Her boyfriend told her he thought getting married might be a solution. "I hope this is not a proposal," she remembers telling him. "Because if it is, it kind of sucks."

It was a proposal, and she said yes. "In retrospect," she says, "I don't think we were ready. But I did love him." Her college friend Bernal, who hosted the small wedding in her building's yard and was a witness and photographer, remembers the ceremony as short and happy.

By 2011, Arce was making $300,000 to $400,000—she won't give the exact amount—and had been promoted to vice president. She replaced her fake green card with a real one from the U.S. government after the wedding. She was legal, elite, and rich. She was also unhappy. The only thing stranger than going from selling funnel cakes in Texas to equity derivatives in New York was how vacant she felt.

Three-and-a-half years after quietly chanting her anxiety prayer in a locked bathroom stall, she took a piece of paper that listed her bonus into the ladies' room. "I made it to this place that I always thought would get me everything I wanted," she says. "But I remember leaving and going to the bathroom with my little letter that said how much money I was being paid and just feeling so empty."

She started a blog, whose first posts counted down her last days at Goldman Sachs. "I am nervous in an excited kind of way. In the way that I imagine a QB is nervous in a rivalry game," she wrote. "I feel responsible to the universe to go and live my dream," she posted the next day. Less than a week later she was gone, writing: "Now is time to go ask more questions and hopefully find more answers."

Arce visited her family in Taxco, flew to Europe on a Mexican passport, and paddled down North Carolina's Roanoke River. She thought she could start a website for arranging impromptu vacations, then a business to get community funding for small ventures; both fell through. She and her husband, who moved away for a job, separated. "Life is all about adapting to change, moving when things are shaken up," she wrote on her blog.

In 2012 a coffee with a friend working at Bank of America Merrill Lynch turned into a job opportunity, and she took it. The role wasn't what she'd thought—mostly project management and compliance strategy. When her boss stopped looking her in the eye, she says, she knew what was going to happen. She was let go last May.

She may have gone back to banking if she hadn't seen a 2013 movie called *Documented*. It follows Jose Antonio Vargas, who was part of a *Washington Post* team that won a Pulitzer Prize in 2008 and came out as an undocumented immigrant in a 2011 *New York Times* essay. "My life on film—I was just so inspired by it," she says. "I basically stalked him."

Arce is moving to California this March as the development director of Define American, a nonprofit founded by Vargas. The group pushes for rights for undocumented immigrants with projects including a campaign to have newspapers drop the term "illegal immigrant" in favor of "undocumented."

The group faces a backlash against rights for immigrants. Former Texas Governor Rick Perry, who signed the bill that allowed Arce to attend college, told a Republican forum in Iowa this year that "if Washington refuses to secure the border, Texas will." Texas Senator Ted Cruz asked his fellow Republicans to "show me where you stood up and fought" an executive action on immigration President Obama announced late last year. (In an awkward coincidence, Heidi Nelson Cruz, the senator's wife, worked in the same Goldman Sachs unit, private wealth management, as Arce.)

Making hundreds of thousands of dollars on Wall Street didn't protect Arce from fear. "There is still the stigma that what we did is shameful," she says. "I'm tired of being ashamed for pursuing my dream, for climbing up the ladder, and for having success."

When asked for comment on Arce's story, Goldman Sachs sent a statement from Chief Executive Officer Lloyd Blankfein: "Wouldn't it be great if we could give a home to more of the talented young people who come to this country for an education and want to apply their energy and skills to supporting our economy?" Goldman now verifies information from job applicants against government records, according to two people at the firm who asked not to be identified discussing its vetting process.

In August, Arce arrived at a courthouse in Lower Manhattan to become a U.S. citizen. She struggled to speak and had to take a breath before reciting the Oath of Allegiance. Her passport came in the mail in September.

She got tattoos after quitting Goldman, including a line linking moles on her left arm. "I guess I just always felt everything happens for a reason, and I just have to connect the dots," she says. "And the one here says Redeemed." She crooks her arm up by her head. "I always sleep like this, so when I wake up every morning it's the first thing I see. It reminds me that no matter what happens, no matter how I feel, I have been redeemed." B —*With Isabella Cota*

"...I WOULD BE ACCEPTED"

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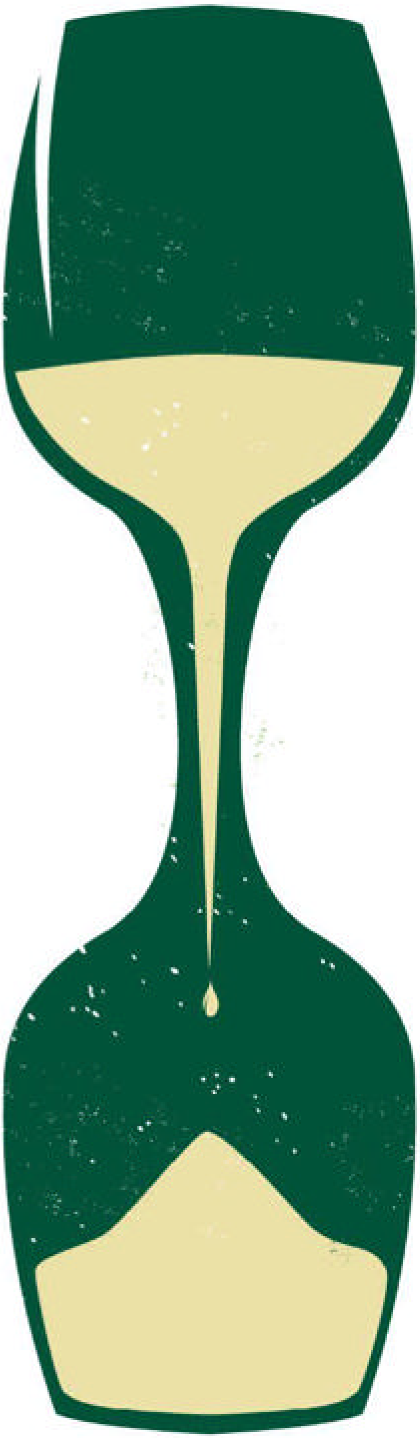
4

1 AT ROOSEVELT HIGH SCHOOL IN 2000, ARCE EXCELLED AT MATH
2 WITH EXTENDED FAMILY AT HER COLLEGE GRADUATION IN 2005
3 IN 2007, AT HER DESK AT GOLDMAN AFTER A LONG NIGHT
4 IN 2001, WITH HER MOM AND SISTER IN FRONT OF THE FAMILY'S FUNNEL CAKE CART IN SAN ANTONIO



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ETC

Spring Fashion

What to wear next, whether you're starting a new job, getting promoted, heading off on vacation, or just looking to blow your bonus

Photographs by Elizabeth Renstrom

New Job

Softer lip colors—like this berry—are gorgeous this spring. Shelve the bold reds and J.Crew oranges for now.

Many designers are updating 1970s motifs. This shift, with its demure silhouette, feels plenty modern.

Cinch the belt tight, or get the dress tailored so it nips in at the waist.

Trademark, by the daughters of Chris Burch, makes smart office sportswear for men and women.

Vary shades of brown in one outfit for a sharp take on tonal dressing.

It's not a trench, it's a mackintosh, with no shoulder epaulets, a more open collar, and no belt. Try this dusty brown, instead of khaki or black, so you don't look like Inspector Gadget.

The midi length is still in style. It's great for spring in a light-colored or pastel fabric.

Yes, you can go sockless at any age. Just hem your pants so it's most noticeable when you're sitting down. (Cuffs should skim the top of your shoes.)

Ignore rules about mixing black with brown or navy—inky heels go with any look.

Pair a lightweight silk or cashmere sweater with a heavier skirt as a streamlined alternative to a blouse.

The rabbit has real fur, but faux looks just as good these days.

Balance the weight of the skirt with chunkier heels, menswear-inspired loafers, or other nondainty footwear.

On her (left)

Trademark henley dress, *$598*; **Jimmy Choo** Ari pumps, *$675*

On him

Billy Reid camel trench, *$795*; **Brunello Cucinelli** virgin wool suit, *$4,160*; **Theory** white button-up, *$195*; **John Lobb** dark brown leather loafers, *$1,555*

On her (right)

Bally silk Cady top, *$695*; **Samuji** Asalt skirt, *$650*; **& Other Stories** high-heel "snakeskin" pumps, *$150*; **Aesa** necklace, *$285*

Get Ready in 10 Minutes

Pare down your morning prep with these multifunctional products

Makeup remover + Facial soap + Hydrator

Ole Henriksen Pure Truth Melting Cleanser, *$34* A gel-like oil that removes last night's makeup (and other gunk) yet leaves behind moisturizing droplets.

Eye shadow + Highlighter

Nudestix Magnetic Eye Color in Angel, *$24* The neutral pigment makes lids look more awake. Or brush on cheeks to add brightness.

Leave-in conditioner + Shine enhancer + Chlorine/saltwater protectant + Moisturizer

Garnier Fructis Triple Nutrition Miracle Dry Oil for Hair, Body & Face, *$6* Originally designed as a hydrating mask, it adds sheen to dry hair, too—same goes for legs and arms. Also protects your strands while swimming.

Foundation + Powder + Sunscreen

Benefit Big Easy Liquid-to-Powder Bigger Than BB Cream, *$38* This fluid evens skin tone, then transforms into a powder to tamp down shine.

One for the guys

Toner + Acne fighter + Ingrown hair remover + Moisturizer

Ursa Major 4-in-1 Essential Face Tonic, *$24* A few drops suck up oil, minimize blemishes, and calm razor burn. Use it in place of regular face lotion. —*Kayleen Schaefer*

On the opening page:

On her (left)

J.Crew denim pajama jacket, *$348*; **Comptoir des Cotonniers** black-and-white knit top, *$142*; **ZAC Zac Posen** shorts, *$495*; **Calvin Klein** pumps, *$595*; **Bally** red cross-body bag, *$1,395*; **Zac Posen** Tennille sunglasses, *$225*

On her (center)

Yigal Azrouël palm plissé dress, *$516*; **Cole Haan** Amalia high sandals in sequoia, *$228*; **Lizzie Fortunato** earrings, *$365*

On him

Burberry blended-cotton trench coat, *$2,595*; **Orley** mosaic polo in navy, *$395*; **3.1 Phillip Lim** trousers, *$389*; **Marc Jacobs** oxfords, *$825*

PHOTOGRAPHS BY ELIZABETH RENSTROM FOR BLOOMBERG BUSINESSWEEK; PHOTO ASSISTANT: ALEX THEBEZ; MARKET EDITOR AND STYLIST: SHIBON KENNEDY; PROP STYLIST: PRISCILLA JEONG; SOFT GOODS STYLISTS: ELIZABETH OSBORNE (PAGES 62, 64, 65, 67, AND 70) AND JOHN OLSON (PAGE 68); HAIR AND MAKEUP: REBECCA GARCIA; STYLING ASSISTANT: JULIE SIMON; PROP STYLING ASSISTANT: PETER B. SAMUELS. ALL RUNWAY IMAGES: IMAXTREE, COURTESY BRANDS. ILLUSTRATIONS BY 731

On the Platform

Stylish people have fully embraced ugly-chic shoes such as Birkenstocks and New Balance sneakers. The next evolution of the trend is platform shoes, which are more stable than heels and more interesting than flats. If your taste is sort of bohemian, wear the wooden-sole ones; if kind of sleek, go for a black pair that adds height. Unlike most other shoes hiding under your desk, **you'll want to bring these home for the weekend**.

Clockwise from top left: **Calvin Klein Collection** black patent Kiera heels, *$1,295*; **Donna Karan** sculpted high-heel mules, *$1,295*; **Bally** Wystan cognac wedges, *$975*; **Joseph** platform sandals, *$655*; **Aldo** red sandals, *$60*; **Sportmax** Fiducia wedges, *$795*; **Pierre Hardy** burgundy sandals with ankle strap, *$775*

Fabric of the Season: Suede

Once worn mostly in the fall, sumptuous suede is popping up in lightweight spring clothes. **For women, classic A-line dresses, shell tops, and trench coats are luxe** in neutrals such as tan and taupe. (Colorful suede can look a bit disco.) **For men, suede is best in outerwear**, such as the navy bomber here, or for a new work bag. Stay away from pants, everybody. And protect your investment with a product like Scotchgard's suede spray. *$10.96; amazon.com*

On her (left): **Vince** suede sleeveless dress, *$895*. On him: **Todd Snyder** navy suede bomber, *$1,695*; **Berluti** white knit, *$1,070*; **Kent & Curwen** camel pants, *$2,250*; **Oliver Spencer** navy suede tote, *$557*. On her (middle): **Theory** suede top, *$445*; **Oscar de la Renta** buffalo-check skirt, *$1,090*. On her (right): **Hanley Mellon** suede jacket, *$1,950*; **Bella Dahl** white button-down, *$125*; **Wes Gordon** skirt, *$1,050*; **Hermès** watch, *$6,950*

After-Work Plans

On her

Jason Wu jacket, *$2,295*; **Donna Karan** cotton canvas dress, *$2,595*; **Donna Karan** plastic belt with leather closure, *$250*; **Jason Wu** black leather handbag, *$2,895*; **Schutz** pumps, *$155*; **Odette NY** gold earrings, *$98*; **Ippolita** lollipop two-stone pendant necklace, *$895*; **Ippolita** gold rock-candy mini single ring, *$550*

On him

Burberry Prorsum selvedge-denim jacket, *$995*; **Burberry Prorsum** olive-green wool-blend trousers, *$795*; **Louis Vuitton** V polo shirt, *$805*; **Florsheim** flagstone cap shoes, *$160*

Try an oversize trench to add a sophisticated vibe. Jason Wu's is made from crepe, which drapes better than traditional cotton gabardine.

Worried about coverage? Wear a cardigan in a contrasting neutral such as navy or olive.

Denim jackets aren't only for rebels these days: A slim one works in place of a blazer or suit for a party.

Many brands are making dressier polos in poplin this spring; tucked into chinos, they're good for Fridays.

The Origami Clutch is small enough not to overwhelm your outfit but doesn't require squeezing under your arm.

Go for trousers, not jeans, so you aren't wearing a Canadian Tuxedo on the commute.

Painterly prints—as seen in collections by Donna Karan and others—are mature enough for work and festive enough for the evening.

Pumps look best with a slightly pointed toe.

Get a $3 shoeshine once a month to keep them clean; it will give them years of extra life.

Better Pants

14 excuses to stop wearing boring bottoms to work every day

Women's

From left: **Hache** chambray trousers, *$460*; **Comptoir des Cotonniers** orange trousers, *$110*; **Paul Smith** navy silk shorts, *$1,005*; **Jason Wu** crepe trousers, *$1,195*; **Wes Gordon** pink pants, *$890*; **Chinti & Parker** navy patterned pants, *$220*; **Stella McCartney** Air Force blue Donna culottes, *$730*

Chambray—like denim but softer—is an easygoing, less wrinkly update on linen.

This bright persimmon would look great with a cream sweater.

Culottes! They're back. Wear with a crisp white blouse, high heels, and some attitude.

Four tricks to wearing oversize pants: chunky wedges, a high waist, a simple shirt, and a floor-skimming hem.

Barely noticeable pleats give these a sophisticated feel. (Not all pleats are bad.)

Sort of like regular chinos, but with tabs at the waist to ensure a great, beltless fit.

Brown *and* gingham, but still not too trendy if paired with a plain oxford shirt.

They're slightly cropped, yes, but they should be long enough to hit your anklebone.

Really baggy. Maybe only if you're very tall.

The tiny navy pattern would work well with other blue clothes.

Still into skinnies? Inject some color.

Men's

From left: **Louis Vuitton** classic trousers, *$890*; **Richard James** white trousers, *$279*; **Giorgio Armani** gingham trousers, *$1,275*; **Orley** cropped camel pants, *$395*; **Brioni** trousers, *$1,710*; **Perry Ellis** red trousers, *$79.50*; **Todd Snyder** olive pants with cuff, *$245*

Wear 'em with a heavy pair of dress shoes to highlight the cuffs.

This mauve is a new take on blazing Nantucket reds.

If you were to invest in one staple: perfect navy wool trousers.

Try a Belted Piece

Coats, suits, dresses, and skirts are tied up this spring

A Few Days Off

On him

Berluti green origami coat, *$4,100*; **Fendi** gray T-shirt with leather contrast pocket, *$700*; **Bally** vintage round sunglasses, *$395*; **Jack Spade** off-white denim, *$228*; **Common Projects** white leather sneakers, *$400*

On her

Vince striped sleeveless tunic, *$195*; **Tomas Maier** dusk painted-palm skirt, *$1,290*; **Charline de Luca** strappy sandals, *$490*; **Oliver Peoples** Jacey sunglasses, *$325*; **Mansur Gavriel** backpack in cammello/rosa, *$745*

Safari coats—with patch pockets at the chest and waist—have emerged as this season's best outerwear for men, whether with a tee or a dress shirt.

Contrasting bands of color at the collar and waist trick the eye into thinking the shirt has a perfect fit.

Tortoiseshell glasses look best with a tan.

Stark-white jeans can be a bit too Miami. Go for a more versatile off-white instead. And if you roll the hems: twice but no more.

Bare arms are nice for vacation, but this outfit would also work at the office with a fitted navy blazer.

With an eponymous New York store, Tomas Maier, the designer of the luxe Italian brand Bottega Veneta, has reintroduced his brand under his own name. He's known for elevated basics and easy-to-wear shapes.

If you're gonna get white sneaks—and you should!—leather's easiest to clean. Try Kiwi's classic shoe whitener. *$5.69; drugstore.com*

The backpack grows up in matte calfskin leather, used by Mansur Gavriel, a rising U.S. bag brand.

Play off the sandals' wispy vibe by painting your nails a nude hue, such as OPI's pinkish Dulce de Leche. *$9; amazon.com*

Pattern of the Season: Loud Stripes

Stripes are always in to some degree, but this spring's version punches them up to 10. Pair one striated item with a dark or light solid—anything in between looks muddy. And, yes, verticals are truly more flattering. If you're feeling sheepish, **the best way to dip your toe in is with a banker's stripe collared shirt** (far left and right).

On him (left): **Bonobos** light-blue-and-white-striped woven shirt, *$85*; **Paul Smith London** trousers, *$410*. On her (middle left): **Ayr** shirt in heather silver, *$125*; **Ace & Jig** Bay pants, *$230*. On him (center): **Gucci** navy-and-white-striped trousers, *$970*; **Orley** yellow knit sweater, *$495*; **Oliver Sweeney** brown suede oxfords, *$379*. On her (top right): **Jimmy Choo** Tarida striped slingbacks, *$895*; **Acne** Saville chinos, *$360*. On her (right): **Paul Smith Black Label** shirt, *$225*; **Calvin Klein Collection** marine technical jacquard pants, *$1,750*

Loafing Around

Loafers were once lambasted for being too preppy or reminiscent of the bad fashions of 1990s Wall Street. Good thing attitudes change: Few shoe styles are more appealing in terms of comfort or versatility. The most restrained ones look awesome worn with dressier suit trousers or casual chinos. Whether you opt for a pair in burnished leather, nubby suede, or some newfangled woven texture, **seek out a more elongated, slightly round toe shape, which will keep your foot from looking stubby**. Tassels are a bit jaunty—so that's your call.

Clockwise from top: **Jimmy Choo** tan loafers with tassels, *$725*; **Florsheim** jet penny loafers, *$125*; **John Lobb** beige suede loafers, *$790*; **Santoni** woven loafers, *$650*; **Michael Kors** brown penny loafers, *$328*

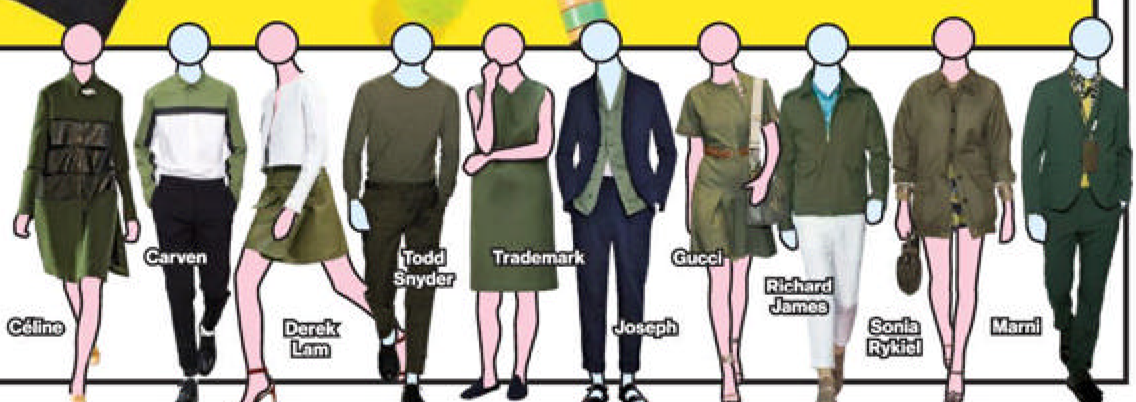
Sporty Details

Technical fabrics such as neoprene, Spandex, and nylon have crept back into stores this season to help your wardrobe on casual days. The strongest pieces feature bold colors and graphic elements—thick stripes, reflective taping, and maybe a little neon—and function best as statements in an otherwise subdued outfit of jeans, solid skirts, and plain tees. You want to look leisurely, not athletic. And unless you're a fitness instructor, don't wear them to a job interview.

Clockwise from top left: **Preen by Thornton Bregazzi** zip-front shirt, *$603*; **Jil Sander Navy** zip-front green jacket with stripe, *$490*; **Carven** tee with large stripe, *price upon request*; **A.P.C. Louis W.** zip-front jacket, *$600*; **Roland Mouret** mesh zip skirt, *$1,375*; **Perry Ellis** grid-knit bomber, *$135*; **Timo Weiland** black track pants with stripe, *$285*

Enlist Some Army Green

Fashion's favorite new (old) hue



As Coco Chanel famously said, "Take one thing off before you leave the house." Limit accessories to just the essentials.

Menswear has inspired women's tailoring for a few seasons, yet the new power suits are perfectly feminine.

Button the jacket to the collar so it doubles as armor.

Although the fabric may seem like heavy tweed, it's cotton. Breathable!

Outdress the plebes in navy by going for a stronger blue suit. This one has a faintly striped texture and slightly intense hue.

New York-based Brooklyn Tailors isn't as hipster as it sounds. The brand makes classic suits, oxford shirts, and cool ties like this one in Italian wool.

Go for slingbacks with a comfy back strap and smart 3-inch height.

Swap a messenger bag for a briefcase with structure. Even better if it's soft leather—not rigid.

On him

Boss T-Harvers/Glover suit, *$1,395*; **Gitman Brothers** woven check shirt, *$165*; **Brooklyn Tailors** burnt-orange tie, *$95*; **John Lobb** Warwick leather lace-ups, *$1,795*; **Michael Bastian** leather briefcase, *$1,200*

On her

Chanel cotton tweed jacket, *$6,500*; **Chanel** cotton tweed skirt, *$2,800*; **Paul Smith** black glasses, *$270*; **Paul Andrew** color block slingbacks, *$875*; **Aesa** pearl earrings, *$245*

Promotion!

Bolder Accessories

Many women own enough black purses to last a week of funerals. Ditto the boring neckties, guys. **When it comes to handbags, choose one of the bright hues landing in boutiques now**. Most have simple hardware and comfortable handles or shoulder straps. Worn with a subdued wardrobe, these bags will pop in a pleasing way. Or use them to amp up an already colorful outfit—just don't match shades exactly. **For men, those floral neckties from the 1980s are back** but in less garish patterns that feel just fun enough to wear to work. Pair big magnolias or pin-dot daisies with a navy blazer for a subtle seasonal touch.

Bags, clockwise from top left: **Milly** blue bag, *$365*; **Calvin Klein** yellow saddle bag, *$198*; **Bally** mint and evergreen sommet-fold tote, *$2,195*; **Jimmy Choo** Alfie handbag, *$1,895*; **Pierre Hardy** black bag with light-yellow and lavender panels, *$1,395*; **Longchamp** tan bag with red details, *$495*

Ties, clockwise from top left: **Brooklyn Tailors** floral tie, *$125*; **Brunello Cucinelli** silk tie, *$295*; **Perry Ellis** floral tie, *$55*; **Oliver Spencer** tan floral tie, *$125*; **Gitman Brothers** floral reversible tie, *$95*

Fresh Looks

Interviews by Arianne Cohen

"I work at a staffing firm, identifying our clients' hiring needs."

"The trench is not too heavy, really comfortable, and absolutely beautiful. It's very different from my comfort zone."

"It's bold! But if I were sitting in a meeting, you wouldn't see it too much."

"I would probably choose one a little bigger, for utility purposes: I carry a lot of files and laptops with me."

"I typically go for closed-toed, and I try to stick with wedges."

Before

Michaela Cummins

25, account executive, Eliassen Group

"Right now, my style is kinda stiff, kinda dull. Usually a button-up and blazer. **I want to look a little more trendy and age-appropriate** yet not distract clients. I'm pretty new to city life—I moved to Manhattan from Columbus, Ohio, in June—so I was nervous I'd get put into something I wouldn't quite go for. But this is great."

Ayr El Bandito trench in pale peony, *$595*; **Theory** Everleen cashmere mock neck, *$275*; **Theory** striped skirt, *$295*; **Calvin Klein** two-tone sandals, *$595*; **ZAC Zac Posen** Eartha satchel, *$595*; **Giotto** ring, *$7,000*; **Miansai** gold ring, *$105*

"My job is to analyze Nasdaq's trading systems and make sure they're up and running."

"It's comfortable—and it almost looks like a suit."

"The tie's my favorite: not too wide or too narrow. I'm a skinny guy, but I don't like wearing one that looks like a pen."

"The pants are skinnier than I'm used to, so I'm not sure how they'd feel after hours sitting in front of a computer."

Before

Ashish Patel

39, senior systems analyst, Nasdaq

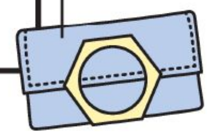
"I'm in a slim-fit suit with a tie every day, but **I'd like to dress a little more modern**. This opened my mind to combining different types of clothing. There are ways to look professional besides wearing a full suit. I'm usually hesitant about colors, but once this outfit was on, it blended together and I felt comfortable."

Theory Wellar sport coat, *$595*; **J.Crew** check button-down, *$88*; **Boss** navy tie, *$95*; **Hermès** Cape Cod watch, *$5,650*; **Polo Ralph Lauren** trousers, *$245*; **Oliver Sweeney** suede lace-ups, $379

How Did I Get Here?

Jonathan Adler Giant Dora Maar Vase, $550

Jonathan Adler Eyes Needlepoint Pillow, $98



Jonathan Adler Goldie Foldover Clutch, $198

Jonathan Adler

Founder and chief executive officer, Jonathan Adler Enterprises

At 13, making a jug at summer camp in 1978

"I grew up in a farm town, but my parents never made me work. The motif you'll find in my career is unemployability."

Education

- Tatnall School, Wilmington, Del., class of 1984
- Brown University, class of 1988

"I was really into fashion and old-school rap music, so I was making Chanel-inspired teapots with blingy gold chains in ceramic."

Work Experience

- **1990** Mailroom assistant, Triad Artists
- **1991** Agent's assistant, Triad Artists
- **1991-92** Assistant, Writers & Artists
- **1992** Assistant, Schindler-Swerdlow Productions
- **1993** Pottery instructor, Mud, Sweat & Tears
- **1994-98** Potter, Jonathan Adler
- **1997-Present** Partner, Aid to Artisans
- **1998** Store owner, Jonathan Adler, in SoHo
- **1998-Present** Founder and CEO, Jonathan Adler Enterprises
- **2007-08** Lead judge, Bravo's *Top Design*

"I got fired. Deservedly so."

Got fired again

In 2010, at a store opening in Newport Beach, Calif.

"I called up a buyer and got an order from Barneys. After a few months I still hadn't gotten paid, so I called, and they said, 'Oh, you're the guy who didn't include an invoice.' And I said, 'What's an invoice?'"

Adler pottery from 2003

"I was off my parents' payroll at 31 or 32."

"One day a customer on their phone said, 'Oh, I'll be home at 8—I'm at Jonathan Adler right now.' And I was like, 'Oh! I'm a place!' When I had a store, suddenly I became a brand."

In 2005

Now has 28 stores and 200 employees

An Adler-designed room at Eau Palm Beach, 2014

Life Lessons

1. "Having a naysayer can be very motivating." **2.** "Be an outsider and an outlier." **3.** "Always think about what's next. Be restless."

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